PAYROLL TAXES, HEALTH INSURANCE, AND SBA BUDGET PROPOSALS

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HOUSE OF REPRESENTATIVES

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PAYROLL TAXES, HEALTH INSURANCE, AND SBA BUDGET PROPOSALS

THURSDAY, MARCH 29, 1990

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The committee met, pursuant to notice, at 9:35 a.m., in room 2359-A, Rayburn House Office Building, Hon. John J. LaFalce (chairman of the committee) presiding.

Chairman LAFALCE. The Small Business Committee will come to order. Today, our committee has invited several of the major small business trade associations to present their views on three subjects of concern to them and to the committee: payroll taxes, health care, and the Small Business Administration budget. We will be hearing from the National Federal of Independent Business, the U.S. Chamber of Commerce, and National Small Business United. I know that my colleagues join me in looking forward to hearing the views of these important groups.

In our hearing on payroll taxes last week, we heard from economists and other experts in Social Security and tax policy. Those experts did not agree in all respects, but a consensus did agree that payroll taxes are regressive and that they probably hurt small businesses more than other businesses. For this reason alone, I believe that a serious effort to effect cuts in the payroll tax cut rate should be mounted.

One such proposal on which I have been working is a bill I first introduced back in 1979 which would remove the Medicare and disability programs from the payroll tax, and fund them from general revenues. My rationale for this proposal was that these programs—unlike the retirement element—bear little if any relationship to the amounts contributed by individual taxpayers through FICA taxes and, therefore, would more logically be financed by a less regressive source of revenue.

With regard to health care and health insurance, 1990 provides a different context than what we saw in 1989. Last year, the biggest concern, and rightly so, was the potentially devastating impact of section 89. A long struggle ensued, but in the end we succeeded in repealing section 89.

But this does not mean that the issue has gone away. Over 30 million Americans, about half of whom are employed, do not now have health insurance. As a result, these people do not get adequate care and, when they need care, the rest of society in one way or another has to subsidize the costs. At the same time, I think that unreasonable discrimination in the provision of health insur-

ance benefits by employers should not be subsidized by the taxpayers if nonburdensome ways of dealing with such discrimination can be found.

In addition to this issue, there is a growing realization in the Nation that our alleged health care system needs serious reform. This in turn requires attention to the very sensitive issues relating to the cost and adequacy of care, along with the question of access to care. With the recent publication of the Pepper Commission's report, the debate continues. It is essential, in my view, that all major sectors of the economy have every opportunity to contribute to this debate, and I hope that the groups with us today will do just that.

Finally, the administration's budget for the Small Business Administration is of concern to many trade associations, and we have heard from several already. I have invited the witnesses before us this morning to share whatever concerns or views, if any, that they might have on the SBA budget.

[Mr. LaFalce's statement may be found in the appendix.]

Chairman LAFALCE. At this time, I would ask unanimous consent to introduce the opening remarks of the Hon. Joseph McDade, vice chairman of the Small Business Committee. Without objection, so ordered.

[Mr. McDade's statement may be found in the appendix.]

Chairman LAFALCE. Let us proceed with our panel. We will have one panel today with three witnesses. My intent is to ask each panelist to give his statement first and then I will open up with a series of questions.

Second, the House is already in session. I do not anticipate being called away for any votes. If this does occur, we will make an effort to minimize any inconvenience.

Third, because of the limited time available and trying to reserve time for members, I would ask that the witnesses limit their presentations to no more than 10 minutes. Your full statements will be entered into the record.

With that, we will call on our first witness, Mr. John Galles, executive vice president of National Small Business United, a post he has occupied for the past 3 years. Among other things, he is a member of the executive committee of the Small Business Administration's National Advisory Council. Previously he was executive director of the Small Business Association of Michigan. He is a graduate of Indiana University. Glad to have you here.

TESTIMONY OF JOHN PAUL GALLES, EXECUTIVE VICE PRESIDENT, NATIONAL SMALL BUSINESS UNITED

Mr. GALLES. Thank you; I am pleased to be here this morning to represent the concerns of National Small Business United [NSBU] before your committee.

I will address more specifically the health care issue because it has become our number one concern as an organization to be addressed on the Federal level. I have some remarks on the payroll tax issue.

I would like to submit written remarks about the SBA budget in the future. With the short notice, we were not in a position to pre-

pare a full statement on each of those. We will get back to you on that.

National Small Business United sees health care access, given the confluence of the rapidly changing labor market, the continuing weak economic position of most individual small businesses, and the sky-rocketing cost of health care and its insurance, to be the preeminent small business issue of the 1990's.

In fact, NSBU recently voted access to health care to be our top priority for 1990. As such, NSBU is actively engaged in the current health care debate and hopes to help shape a health care reform which opens up access, contains costs, and is beneficial to all concerned.

The problems facing this country and its small businesses in the area of health care is manifold and complex. Let me address one initial concern before we get into dialogue about the issues that go beyond that.

The first issue which every small business owner in this Nation, I think, once informed would stand behind is opposition to a federally mandated health insurance plan. That would be detrimental to employers. We have found nearly 85 percent of our members in a quick poll of our group gave us that response.

The cost of an average worker's family policy averaged nearly $3,000 in 1988 and the costs continue to rise. The same firms that employ most of the uninsured workers—the ones with fewer than 25 employees—are the ones that most often operate on the margin, have the greatest rate of turnover, and are most likely to go out of business. There is a reason why they do not have health insurance—quite apart from the usual image of being greedy and uncaring: They simply do not have the means. Nothing in a mandated approach would change that situation.

At the bottom end of the pay scale, there simply is no flexibility in wages; a mandated approach would allow no flexibility in benefits.

Mandating employers to do more of what they already cannot afford is no solution at all. There are many specific arguments to be made against specific mandated approaches. We shall not go into all of those because any mandated plan will be completely inadequate and unacceptable because it fails to address the essential problem of small business health care in the United States: its cost.

There are many contributing factors which make health care and its insurance expensive for all concerned. There are still other factors which cause these costs to be higher still for small employers.

The most essential cause of the high cost of health insurance is the high cost of health care. There is little incentive to search out more affordable ways to the same level of health; high technology makes many procedures more palatable for most people, increasing the demand, and price, for those procedures; health care providers' liability insurance premiums substantially drive up their costs; and the cost-shifting problem feeds upon itself, causing high cost to lead to higher cost in a never-ending upward spiral.

The cost-shifting problem is a result of the uninsured and cutbacks in Medicare and Medicaid. In the first Reagan administration, a plan was enacted that allowed Medicare to set limits on the

amounts it is willing to pay to doctors and hospitals for specific sorts of medical care. The measure was designed to combat the rising cost of health care. The thought was that Medicare was being overcharged because it was willing to pay.

Medicare's prospective payment system was instituted to deliver a fair, not bloated, recompense to doctors and hospitals. Beyond the frequent charge that these regulations have reduced the quality of health care received by our elderly, there is also evidence that this plan is actually driving up health insurance prices—some say by as much as 20 percent—for all other consumers.

Aside from the cost-shifting and medical liability problems, health care costs will continue to rise because the public will continue to receive more and more new treatment as that treatment becomes more and more convenient and effective and continues to be paid for by someone else.

The fact is that, for the insured, there is almost no consumer sensitivity at the point of demand. There is no incentive to shop for a better price or to reject painless care that may be unnecessary. The fact is that real and meaningful cost containment will involve requiring those who can afford it to pay an increasing share of their health care bills—as distinct from their premiums, which would cause no decrease in aggregate health care costs. We are talking about payment of health care bills, not payment of health care premiums.

Essentially, as we move into the 21st century, aggregate health care is becoming more expensive because there is becoming more of it. For so long as insurance continues to pay for new procedures—ever increasing in numbers—its price will continue to rise, and fewer Americans will be able to afford it.

In order to cope with this problem, insurers are requiring advance approval for surgery and Medicare has adopted a new method of restricting unnecessary stays. Nevertheless, health care has risen from 10.4 percent to 11.1 percent of the national GNP since 1985. In 1965, it was 5.9 percent.

Small businesses tend to provide a lower level of health insurance to their employees than larger businesses. The simple reasons for this disparity are high health care costs and, frequently, low small business profitability.

Insurance premiums are higher for smaller companies than for their larger counterparts because they have fewer employees over which to spread the risk. The work force employed by these small firms is also a problem. Small businesses employ a disproportionate number of older workers, part-time workers, and women—all of whom tend to have higher-than-average health insurance premiums.

Further, the employees of the smallest firms must endure an individual underwriting process. Each employee's health record is investigated in order to determine, individually, the appropriate level for premiums. The cost of running these analyses is also then passed on to the consumer in the form of higher premiums.

The Health Insurance Association admits firms with fewer than 25 employees pay 30 percent to 40 percent higher premiums than employers with more than 25 employees. GAO reports that premiums for those employers continue to rise at a rate 50 percent great-

er than the rate of increase for all other employers. The problem is that small, marginal companies actually get a substantial, and very discriminatory, price hike.

All of these concerns need to be addressed before we can revisit a section 89 and look to eliminate discrimination taking place now comes from the imposition of rules and regulations on small businesses by insurance companies.

Insurance companies claim the major reasons for the disparity in costs are acquisition costs and the lower renewal rates among small firms. Insurers' marketing costs are higher per business because there are so many small businesses to market.

Few who actually buy from any particular company and must be repeated more often because of the low rate of renewal. There are many other overhead and administrative costs which are higher for smaller firms, such as tracking of employees, maintenance of accounts, billing and collection.

The insurers claim that the major way to reduce these costs is to increase the size of the risk pool, yet through their rapid retreat from a community rating system, they are the ones who are segmenting that larger pool.

Moreover, due to the expiration of preexisting condition provisions, insurance companies consistently raise rates in the second year of a plan to levels which are unacceptable to small businesses.

In addition, if employee conditions become present, conditions like high blood pressure, heart disease, cancer, arthritis, you name it, any condition which drives up the claims that are made by employees of a firm will drive up that premium substantially.

These price hikes in the out years—which are a direct result of the individual rating system and its preexisting condition provisions—cause employers to switch insurance companies—when they can—with great frequency. This effect, called churning, is something which needs to be addressed before we can depend on small businesses giving health care without discrimination to their employees. That churning effect is a direct result of the pricing policy of the insurance providers.

In order to correct these inequities, we must take steps now to move back to a less discriminatory and a broader based system and move away from the current individually rated system for small business.

Smaller employers are lacking in other resources that are at the disposal of larger employers. Large employers are in a position to self-insure and many times negotiate for services which they are prepared to pay. Those rates may be less than those providers would provide to smaller employers.

Small providers currently don't have the ability to gain a market share where health insurance is provided and negotiate that special arrangement. It is ironic that it has largely been bigger businesses that have complained about the impact of cost shifting on their bottom lines.

These big businesses have suggested that, if more small businesses insured more of their employees, health insurance costs would not be shifted to big businesses. It is ironic because the only employers who are paying the full cost of the health care, who are not

receiving special deals, who are the hardest hit are small employers.

Perhaps if larger businesses paid the real, unreduced costs of their health care bills, costs to small employers could be reduced to the point where many more of them could afford to provide health care for their employees.

There are solutions. We presented those in our testimony. We talked about changes in the ERISA rules which would allow small employers to be in a position to negotiate with their providers.

We have talked about eliminating mandates within individual States. You have heard some of that testimony in the past. Those mandates simply drive up costs in a way which again lays a disproportionate impact on small business.

I am going to skip over a couple of other remarks here simply to get to the Pepper Commission because I think you deserve a response to your questions about that.

There are good and bad elements to the Pepper Commission recommendations. Certainly, first is the employer mandate on the bad side of the ledger. The total cost to small business, if that Pepper plan were put in place, would be about $40 billion per year to small businesses. It is clearly an unacceptable choice from a small business perspective.

But on the other hand, I would like to seize upon the good elements of the Pepper Commission recommendations. They have urged dramatic reforms in the delivery of health insurance.

They recommended a move to community-rated insurance which would eliminate the medical screening and health underwriting practices which limit or prohibit coverage on preexisting conditions. They have encouraged the preemption of State mandates, and they have also suggested that we fairly set the deductibility of employer-provided health insurance at 100 percent for all employers.

I think it is important to seize upon those initiatives because those initiatives can be accomplished without adding to our Federal deficit.

The biggest reaction to the Pepper Commission was the cost and the fact that we can't accept a $60 billion increase in Federal spending at a time when our deficit is as large as it is. Let's make an effort to implement those recommendations that don't cost the Government money.

The major failings of the Pepper Commission really fall not on cost as much as the lack of attention they pay to medical liability reform and overall cost containment. We really need to get to those issues if we are really going to help small businesses respond and provide health care for more of their employees.

I will simply end my remarks about health insurance there and hope we can discuss those.

With regard to payroll taxes, we certainly would stand in support of being careful about how we force payroll taxes on small businesses. It is crippling to small business employment, but we are also reluctant to see the Congress make a quick action and support a proposal like Senator Moynihan's. We are not anxious to see that kind of reform take place at this point in time.

While it may be a cost savings today or next year, the cost increase to small business in the future will be substantially more than they will realize in the short run. We would much rather see Members of the House stand behind Congressman Rostenkowski's proposal for deficit reduction.

I will be submitting remarks with regard to the SBA budget at a later date.

Chairman LAFALCE. Does that mean the NSBU is in favor of freezing Social Security benefits tax and increasing the gasoline tax?

Mr. GALLES. Yes; there were other parts. We are supporting the whole package.

Chairman LAFALCE. I support the package, too. When I visited with Mr. Rostenkowski yesterday, he mentioned a lot of Members of Congress agreed to support his proposal as long as they could be the 217th, 218th, or 219th vote on the proposal. Thank you for your time.

[Mr. Galles' statement may be found in the appendix.]

Chairman LAFALCE. Our next witness will be Mr. Frank Mason, representing the U.S. Chamber of Commerce.

Mr. Mason is from Alabama, owns and manages a building products business, the Mason Corp., headquartered in Birmingham, and has other facilities in Dallas, Kansas City, Roanoke, NC, and Baton Rouge, LA.

In addition, he has served on a number of regional and national business groups and advisory boards. Right now he is, among other things, a member of the National Advisory Council of the Small Business Administration and a member of the employee benefits committee of the U.S. Chamber of Commerce.

He has come to Washington on many occasions to represent the interests of the small business community, and so I am pleased to welcome him once again.

Mr. Mason, Mr. Galles forgot how to keep time, and I didn't remind him.

TESTIMONY OF FRANK MASON, CHAIRMAN OF THE BOARD, MASON CORP., ON BEHALF OF THE U.S. CHAMBER OF COMMERCE; ACCOMPANIED BY CHRISTINE RUSSELL, SMALL BUSINESS CENTER, U.S. CHAMBER OF COMMERCE

Mr. MASON. I will try to limit the remarks to certainly less than 10 minutes.

We have written testimony. I would like the opportunity of highlighting a few points. I will attempt to stay within some limits here.

I want to thank you and the members of the committee for the opportunity of being here on behalf of the U.S. Chamber of Commerce. With me is Christine Russell, who heads the Small Business Center for the U.S. Chamber. We appreciate this opportunity to exchange views.

I want to personally take this opportunity to thank you and those who work with you on behalf of repeal of section 89. The small business community is in your debt with that effort. Those of

us who have followed these things really need to say thank you. We do, and we appreciate that effort.

Chairman LAFALCE. Thank you.

Mr. MASON. It meant a great deal to be relieved of those burdens.

With regard to Social Security, in 1986 I led the Alabama delegation to the White House conference from Alabama. Part of a group that looked into the area of payroll taxes.

One of our recommendations which emerged as prior to No. 8 of the entire conference concerns Social Security. We called for a freeze at that time on the tax rate and the way it is based at the 1986 level, and suggested further reductions in tax rates as well as exploration of long-range alternatives to the present Social Security system, which does place undue and inequitable financial burden on businesses and their employees.

The Chamber endorsed this recommendation. No freeze occurred. The Social Security taxes have risen twice since then, from 1980 to 1990, the basic payroll tax rose from 6.13 to 7.65, a 25-percent increase.

Over the same period, the taxable wage base went from $25,900 to $51,300. Combined, the two factors increased the top amounts from $1,588 to $3,924, the maximum tax paid by self-employed rose as well. The result of this escalation is the Social Security system is taking in more than it needs to pay for current benefits.

It has been highlighted these excess taxes are not being saved for a rainy day, but instead are being borrowed by the Treasury and used to finance current spending.

The FICA tax burden falls heavily on small business for a number of reasons. Generally, they are more labor intensive than the larger firms. The average wages are lower so that the rates almost automatically carry the full impact on additional employees.

Small business was responsible for more than 60 percent of the new job creation in the 1980's. Pressures restraining job creation continue to mount, and high Social Security taxes must be considered an element in that process.

Unlike the income tax, the payroll taxes have no relation to a company's profitability. The Chamber strongly believes it is desirable to reduce the Social Security tax rate and the general burden of taxation as well as the growth rate in Government spending.

Therefore, the Chamber urges Congress to reduce Social Security payroll taxes matched by a reduction in expenditures necessary to meet the Gramm-Rudman-Hollings deficit reduction targets without increasing other taxes to make up for those reductions.

There are some comments on the unemployment tax and payroll deposit system. But in the area of health care, as has been pointed out, the problems of the increased health care costs and the growing gaps in health coverage have been well-documented in recent years. The plight of the small business in the health insurance marketplace may not have been as well-documented.

According to the Census Bureau, the 15 of approximately 31 million Americans who lack health insurance are full-time-, full-year-employees, and their dependents. More than 43 percent of the employed uninsured work with firms with fewer than 25 employees.

Most small businesses want to offer health insurance to their employees, but many find health insurance difficult or nearly impossible to obtain or completely unaffordable. Medical cost inflation has taken its toll.

Overall, businesses currently face annual health care cost increases averaging 20 percent, with many small businesses hit with increases of 40 percent or more. Since 1980, employer-paid insurance costs have risen dramatically.

One issue that may have some bearing on the ability of small businesses to furnish that coverage is the fact that current tax laws discriminate against self-employed, primarily small business owners, by allowing only a 25 percent deduction for their health insurance, while corporations may deduct 100 percent.

Another point, many times small business employers do not have sufficient assets to insure their health care risks. These companies must purchase insured plans which are regulated at the State level and State-mandated benefit laws require carriers to include benefits that add an estimated 20 percent to the cost of health plans in some States.

Finally, the increasing trend toward self-insurance by medium- to large-sized firms has caused health insurance companies to maximize their profits in the small group market.

The forces of tough competition in the health insurance industry are driving insurance companies to stricter underwriting practices for small business.

It is the feeling of the Chamber that we must return to the traditional concept of insurance. That is the broad spreading of risk across a wide population.

Specifically, insurers in the small business market should accept all employees when providing group coverage to a company; guarantee the renewal of a group at pooled rates once the group has been accepted; impose no new preexisting condition limitations on an individual that has been continuously insured, when that person changes employment or coverage, and provide a reinsurance pooling mechanism to provide direct access to small employers who otherwise have been rejected and to spread risks among participating insurers and HMO's.

Also attached to our testimony are comments with regard to the Pepper Commission. I would certainly echo the position that was expressed earlier that mandated benefits are not in the best interest of expanded coverage and the small business community.

I would like to thank the committee for giving us the opportunity to enter some information into the record on those issues, and would be happy to answer any questions you may have.

I would like, if possible, to allow the possibility of additional comments at a later time—a written submission for the issue of the SBA budget items there, if that might be possible.

Chairman LAFALCE. We will keep the record open and actively solicit your further comments on that and other issues.

Mr. MASON. Thank you.

[Mr. Mason's statement may be found in the appendix.]

Chairman LAFALCE. Our third witness, I am pleased to say, is Mr. David Rehr. He is the assistant director for Federal Government Relations at the National Federation of Independent Busi-

ness. Mr. Rehr has been there for 2 years, before which he was an executive assistant to our colleague, Representative Vin Weber.

Mr. Rehr holds a master's in economics from George Mason University and earned his undergraduate degree at St. John's University in New York City.

Mr. REHR. Minnesota.

Chairman LAFALCE. He has continued his academic work and is a Ph.D. candidate of economics at George Mason.

Mr. Rehr was extremely helpful to the chairman and to the other members of the Small Business Committee as we pursued repeal of section 89. Indeed, I think I can say if it weren't for his arduous work, we may well have not have succeeded.

I am pleased to welcome you to this hearing, Mr. Rehr, and look forward to hearing your views on these issues of the day.

TESTIMONY OF DAVID K. REHR, VICE PRESIDENT FOR FEDERAL GOVERNMENTAL RELATIONS, HOUSE, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Mr. REHR. On behalf of the over 570,000 members of the NFIB, we appreciate the opportunity to testify on three important issues before us.

Like my colleagues before me, I would ask that we provide written comments on the SBA budget at a later time so I can focus my testimony on the need for a payroll tax cut and the need for some relief on the health insurance side for small business.

Before I go into those two points, though, I would like to thank the chairman and the committee for dramatically increasing the visibility and credibility of the committee.

What you did not mention in the background of David Rehr is that I used to be on the staff of the House Small Business Committee. When I was on the staff of the Small Business Committee, unfortunately, we really didn't deal with the issues which really mattered to mainstream business.

Mr. Chairman, you are doing that today and the members of the committee are doing that today. That is extremely helpful to small business across the country.

Chairman LAFALCE. Thank you very much, Dave. I talked to the chairmen about that. They said they didn't have the staff to handle it at the time.

Mr. REHR. Let me go to the first point. That is the need to cut payroll taxes.

I don't want to cover ground that my previous colleagues covered, but I want to make a couple of points. The first is that payroll taxes are an increasing tax burden on this country, and in particular on the small business community.

One startling statistic that I always like to mention is that since 1955, the basic payroll tax has risen over 400 percent. What does that mean to small business in America?

In a 1980 NFIB study, payroll taxes dominated by FICA comprised more than 50 percent of the total tax burden paid by the average small business person in this country. That means that more small business owners in this country pay more income to FICA than they do in personal income taxes.

What else does that mean? It means that the growing total percentage of Federal receipts, the total tax burden has shifted. In the early 1960's, for example, FICA represented about 9 percent of the total tax receipts. Today, it represents over 36 percent of the total tax receipts, which shows you how it has dramatically grown as a tax burden.

Why does NFIB support a tax cut and why are payroll taxes harmful to job creation and small business expansion? First, it is a first-hour tax. Before the average small business owner opens his door, he pays the FICA tax. It is not a tax on personal income. It is not a tax on corporate income. It is a tax that must be paid before $1 of revenue is generated, whether or not any revenue is generated at all.

Second, the increasing burden of payroll taxes has resulted in a capital labor substitution, meaning that at the margin when the small business owner has to decide whether he is going to hire another employee or pay a higher FICA tax or bring in a machine which will do essentially the same thing, he opts for the machine.

Third, small business costs. This is a point that Frank has already mentioned. The 1986 White House conference supported an immediate freeze at the 1980 rates on the FICA tax.

Fourth, the increasing FICA tax burden is placed disproportionately on the self-employed. Most people don't realize that the self-employed pay both the employee and the employer side. Up until recently, the self-employed were allowed a 2 percent credit, which made the situation a little easier, but that is now being eliminated.

Over 32 percent of the jobs in this country are related to self-employed people. Now 32 percent of the jobs in this country will now be paying a higher tax, a rate higher than 15 percent.

Fifth, the 1983 Social Security Commission history. The biggest argument for a FICA tax cut, an immediate FICA tax cut, is that the Commissioners on the 1983 Commission had no idea about the revenue inflow based upon the dramatic economic growth we have experienced in the decade of the 1980's.

It is my understanding that the revenue is over upwards of billions over the most optimistic projections that the committee had at the time. Not the base projection, not a rosy scenario, but billions higher than the most optimistic projection.

We are being told by the administration and by some on both sides of the political spectrum that we can't cut the taxes. But in 1983 no one knew that we would get this amount of revenue in from the FICA increases.

So if you can look at the argument in 1983, if we step back in history and we say to ourselves, OK, let's just go with the most optimistic projection that the Commission had at the time, we are dramatically over that today.

Let me go to the issue of the Rockefeller Commission and health insurance. I want to wind up fairly quickly.

Point 1, the mandate issue which John Galles has already mentioned was extremely controversial in the Commission and is counterproductive for small business.

I ask that in the record we include a graph produced by the Blue Cross and Blue Shield Association which shows the dramatic

number of State mandates, how the State mandates have grown over the years. There are now over 686.

What does that mean? If the Federal Government wants to impose a mandate on small business, we only need to look at the examples within the States which shows where you have more mandates, you have higher insurance costs, you have greater use of insurance, you have more uninsured.

Point 2, NFIB members believe we need to look at health insurance differently. We have to approach it in terms of a long-term solution and an immediate short-term solution. Unfortunately, it is our estimation that the short-term solution is being overlooked by many Members of Congress because it is not sexy.

We can reduce the uninsured in this country by 8 million if we adopt the chairman's bill and have 100 percent deductibility of health insurance to noncorporate business entities. Really that is not a sexy issue. We should do that today.

My final point, number 3, we need to continue to focus on individual responsibility. I ask the committee to insert into the record additional graphs dealing with this issue from an NFIB Foundation survey in 1989.

The most important thing that we can do from Washington is twofold. One, educate the culture that health insurance is important and necessary. Two, respect people's wishes who choose to have alternative policies.

Let me close by saying that NFIB supports an immediate cut in the payroll tax and that we oppose any sort of health mandate being imposed on the small business community.

I again appreciate the chairman asking us to testify today.

[Mr. Rehr's statement may be found in the appendix.]

Chairman LAFALCE. Thank you very much. We now have approximately 6 minutes to make this vote. I have discussed the issue with the other members on the panel. Although they have many questions, it is the collective desire to submit the questions to the members of the panel and have you respond in writing. I think primarily because I happen to be under the weather.

Mr. SISISKY. Mr. Chairman, we have made a motion to make all of their statements a part of the record?

Chairman LAFALCE. Yes; at the very beginning. Because of that, we will be following up to you privately with letters and asking you to respond, particularly, I think to the SBA budget submissions.

I appreciate your testimony. I appreciate your position on the Social Security payroll tax. It has been a longstanding one of mine. I personally think we need to offset it with increased revenue some place. Otherwise, it is just incomplete.

How do we do that? Would you be willing to do that? I would hope so.

One possibility is tax a higher percentage of Social Security benefits. The tax on Social Security benefits now is 50 percent. If we tax that 85 percent on those benefits, which all economists say we can tax more than that, we will still be taxing after tax benefits.

If we put that money into general revenues rather than the Social Security Trust Fund, which reason compels you to do, then

you might well be able to reduce the Social Security payroll tax and wind up revenue neutral. Those are other options, too.

One option is to eliminate or increase the cap which would adversely impact 3 million Americans, benefit the 120 million Americans. Then, of course, too, that money goes into the Social Security Trust Fund. If you are not going to count toward the deficit, but you would be able to lower the rates significantly.

Although there are a lot of small business owners who make more than $50,000 where the cap is $51,000, $53,000 there are far, far more who make less than that. I think they would prefer having a lower rate for themselves and their employees, if possible.

Mr. IRELAND. Mr. Chairman, the CBO has a list. I think it contains 124 specific proposals that cut spending. Perhaps you could enlist some of your colleagues on the other side of the aisle to address some of those?

Mr. SISISKY. We had to be very careful. They found a way to cut it.

Chairman LAFALCE. On this partisan note.

[Whereupon, at 11:20 a.m., the committee adjourned, subject to the call of the Chair.]

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APPENDIX

OPENING STATEMENT BY CHAIRMAN JOHN J. LaFALCE

March 29, 1990

Today the Committee has invited several of the major small business trade associations to present their views on three subjects of concern to them and to the Committee: payroll taxes, health care, and the Small Business Administration budget. We will be hearing from the National Federal of Independent Business, the U.S. Chamber of Commerce, and National Small Business United. I know that my colleagues join me in looking forward to hearing the views of these important groups.

In our hearing on payroll taxes last week we heard from economists and other experts in social security and tax policy. Those experts did not agree in all respects, but a consensus did agree that payroll taxes are regressive and that they probably hurt small businesses more than other businesses. For this reason alone I believe that a serious effort to effect cuts in the payroll tax rate should be mounted.

One such proposal on which I have been working is a bill I first introduced back in 1979 which would remove the medicare and disability programs from the payroll tax, and fund them from general revenues. My rationale for this proposal was that these programs -- unlike the retirement element -- bear little if any relationship to the amounts contributed by individual taxpayers through FICA taxes and, therefore, would more logically be financed by a less regressive source of revenue.

With regard to health care and health insurance, 1990 provides a different context than what we saw in 1989. Last year

the biggest concern, and rightly so, was the potentially devastating impact of Section 89. A long struggle ensued, but in the end we succeeded in repealing Section 89.

But this does not mean that the issue has gone away. Over 30 million Americans, about half of whom are employed, do not now have health insurance. As a result, these people do not get adequate care and, when they need care, the rest of society in one way or another has to subsidize the costs. And at the same time, I think that unreasonable discrimination in the provision of health insurance benefits by employers should not be subsidized by the taxpayers if non-burdensome ways of dealing with such discrimination can be found.

In addition to this issue, there is a growing realization in the nation that our alleged health care "system" needs serious reform. And this in turn requires attention to the very sensitive issues relating to the cost and adequacy of care, along with the question of access to care. With the recent publication of the Pepper Commission's report, the debate continues. It is essential, in my view, that all major sectors of the economy have every opportunity to contribute to this debate, and I hope that the groups with us today will do just that.

Finally, the Administration's budget for the Small Business Administration is of concern to many trade associations, and we have heard from several already. I have invited the witnesses before us this morning to share whatever concerns or views, if any, that they might have on the SBA budget.

Before proceeding, let me deal with some housekeeping matters. First, we have one panel today with three witnesses. My intent is to ask each panelist to make his statement first, and then to open up the session for questions. Second, the House will be in session today starting at 11:00. We do not anticipate being called away for many votes, if any, but I wanted to alert the witnesses and the audience that this may occur. If votes do occur, we will make every effort to minimize the inconvenience. Third and last, because of the limited time available and the desire to reserve time for questions from the Members, I would ask that the witnesses try to limit their presentations to no more than ten minutes. Your full statements will, of course, be entered into the record.

March 29, 1990
Ronald K. Machtley
Small Business Committee Hearing

I am pleased that the Small Business Committee has chosen health care and health insurance as topics in today's hearing, and I appreciate the opportunity to hear testimony from our witnesses on recent recommendations for addressing our health care needs.

Some forty million Americans have no health coverage whatsoever. In my state of Rhode Island, the percentage of individuals who lack health insurance has increased to as high as seventeen percent, placing a growing burden on hospitals and community health centers and posing a major challenge to policy makers.

Although some of those individuals in my state who report they have no health insurance may be eligibile for Medicaid, the number of individuals without insurance demonstrates a dramatic increase over 1975, when the Health Department estimated that 3% of Rhode Islanders were uninsured. And there has been a doubling of the uninsured in my state since only five years ago, when 8% of Rhode Islanders were reported to have no health insurance.

The growth in numbers of uninsured people, despite a low unemployment rate, suggests that fewer workers are getting health insurance through their employers. This reflects an increase in the number of people employed in service-industry businesses such as restaurants and hotels which tend not to offer health insurance and soaring premiums which have made health insurance prohibitively expensive for many small companies.

I do not support placing a mandated health insurance burden on small firms. The majority of small companies that do not provide full health coverage to their employees do not provide health insurance for the same reason that many individuals do not buy insurance -- it is not economically feasible.

Nonetheless, we cannot concede defeat to spiraling health costs. The risks to our society and our future are too great. Our future and the potential for our country depend upon our ability to find answers to these problems. The base of our future - children - constitute over one-third of the domestic uninsured population. In fact, the gap between the Medicaid and employer-provided health care systems has left over sixteen million children age 22 and younger without health insurance, and over one-quarter of all women in their childbearing years either have no health insurance or have health insurance that does not cover maternity care.

So, where does that leave us? What can we as policy makers look to small businesses to achieve? Number one, we must provide incentives for small firms which make it economically possible for them to increase the health benefits they are able to provide.

For example, I have co-sponsored legislation (H.R. 595) which secures a 25% deduction on health insurance for self-employed

individuals, and additional legislation (H.R. 694) which would provide 100% deductibility on health insurance for unincorporated businesses -- the same as that given for corporate firms.

We cannot continue to ask small firms to provide the same health insurance coverage as large corporations are able to offer. We should still encourage small business to offer health coverage. However, we must offer solutions to small business which, rather than broad mandates, provide incentives which make it economically viable for these firms to make the economic commitment to employee health insurance.

STATEMENT
OF
THE HONORABLE JOSEPH M. MCDADE
VICE CHAIRMAN
COMMITTEE ON SMALL BUSINESS
U.S. HOUSE OF REPRESENTATIVES
FULL COMMITTEE HEARING
MARCH 29, 1990
******

Mr. Chairman, I commend you for holding this hearing today to further explore several problems adversely affecting small firms in the United States.

As we heard a few weeks ago, small businesses bear a disproportionate share of the payroll tax burden unlike their larger counterparts. This occurs because small firms are labor intensive. Larger businesses, which are generally more dependent on automation and advanced technology, are less labor intensive and, therefore, their FICA burden is less. Most worrisome to me is the impact that FICA taxes have on the self-employed who are forced to pay the entire FICA burden. I am afraid this may be a leading cause of failure experienced by self-employed firms, and it may be discouraging ambitious, well-trained, highly motivated men and women from opening their own firms.

Similarly, I am troubled by the unavailability of health insurance to small firms or, when available, the high premiums the firm's owner must pay to receive it. These worsening problems are stifling the success of existing concerns and frustrating the entrepreneurial desire of many Americans.

Mr. Chairman, a recent report by the U.S. Small Business Administration concluded that, over the next 25 years, the United States, just to maintain its current level of employment, will have to produce 43 million new jobs. The analysis estimates that at least 75 percent of these jobs would have to come from the nation's small firms. For them to achieve this, barriers to small business creation and growth must be addressed and, where possible, eliminated. This series of hearings can be the start of our attempt to ensure the creation of these jobs and thus guarantee a vibrant American economy well into the 21st century.

Thank you, Mr. Chairman.

NATIONAL SMALL BUSINESS UNITED

"Serving America's small businesses since 1937"

Statement
of
John Paul Galles

on behalf of
National Small Business United

regarding
Health Care Reforms, Payroll Taxes and other Small Business Issues

before the
U.S. House Committee on Small Business

March 29, 1990

1155 15th Street N.W. Suite 710, Washington, DC 20005
Telephone: (202) 293-8830 Telecopier: (202) 872-8543

Good morning. My name is John Paul Galles, and I am the Executive Vice President of National Small Business United (NSBU). I am pleased to be here this morning to represent the interests of small business on several key concerns which are before the Committee at this time. We at NSBU are very glad that the Committee has chosen to deal with these very difficult issues. We will do whatever we can to help.

As you may well know, National Small Business United is the oldest association exclusively serving the small business community of our nation--for over 50 years now. NSBU is a volunteer-based association of small businesses from across the country, founded from a merger of the National Small Business Association and Small Business United. NSBU serves over 50,000 individual companies with members in each of the 50 states, as well as local, state, and regional associations. We think we uniquely represent the small business community of this country.

I. Health Care Reform

National Small Business United sees health care access, given the confluence of a rapidly changing labor market, the continuing

weak economic position of most individual small businesses, and the sky-rocketing cost of health care and its insurance, to be the preeminent small business issue of the 1990's. In fact, NSBU recently voted access to health care to be our top priority for 1990. As such NSBU is actively engaged in the current health care debate and hopes to help shape a health care reform which opens up access, contains costs, and is beneficial to all concerned.

The problems facing this country and its small businesses in the area of health care are manifold and complex. They include the interlinking spiral of health care and insurance costs, the significant number of uninsured people in this country, the inability of small businesses to solve the problem alone, and the conflict of finding a solution to one aspect of the problem without worsening another.

Mandates

In a recent NSBU survey, 82% of respondents said that a federally mandated health insurance plan would be detrimental to them as employers. Still, many in Washington consider the most obvious solution to the crisis of the uninsured is to require all employers to insure their employees. The cost of an average worker's family policy averaged $2,986 in 1988, and the costs continue to rise. The same firms that employ most of the uninsured workers--the ones with fewer than 25 employees--are the ones that

most often operate on the margin, have the greatest rate of turnover, and are most likely to go out of business. There is a reason why they do not provide health insurance--quite apart from the usual image of being greedy and uncaring: they simply do not have the means. And nothing in a mandated approach would change that situation.

At the bottom end of the pay scale, there is no flexibility in wages; a mandated approach would allow no flexibility in benefits. The only flexibility allowable would be the flexibility of whether to fund the job itself. The choice between a job or adequate health care is no choice at all, either for the employer or the employed. It should not be a choice for Congress either.

Mandating employers to do more of what they already cannot afford is no solution at all. There are many specific arguments to be made against specific mandated approaches. We shall not go into all of those because <u>any</u> mandated plan will be completely inadequate and unacceptable because it fails to address the essential problem of small business health care in the United States: its cost.

<u>Health Care Costs</u>

There are many contributing factors which make health care and its insurance expensive for all concerned; there are still other

factors which cause these costs to be higher still for small employers. The attempt here shall be to address both the larger, more basic cost problems which infect our entire health care delivery system and the particular problems within the current system which are so ruinous for small businesses. With those problems and our suggested solutions in mind, I shall then try to analyze the recommendations of the Pepper Commission as they affect small business.

The most essential cause of the high cost of health insurance is the high cost of health care. There are, however, many reasons for the high cost of health care. Within the current system, there is little incentive to search out more affordable ways to the same level of health; high technology makes many procedures more palatable for most people, increasing the demand (and price) for those procedures; health care providers' liability insurance premiums substantially drive up their costs; and the cost-shifting problem feeds upon itself, causing high cost to lead to higher cost in a never-ending upward spiral.

The cost-shifting problem is a result of the uninsured and cutbacks in Medicare and Medicaid. Cost-shifting results when the medical community treats patients who are unable to pay (or unable to pay their full bill). Those doctors and hospitals then pass those unpaid bills on to others (the deep-pocketed insured) in the form of higher costs. In other words, a large part of medical cost

inflation results from the fact that the uninsured are still being treated, the elderly are getting more care than Medicare will pay for. The result is that everyone else is unwittingly footing the hidden bill for the uninsured and the underinsured in the form of cost-shifting.

In the first Reagan Administration, a plan was enacted that allowed Medicare to set limits on the amounts it is willing to pay to doctors and hospitals for specific sorts of medical care. The measure was designed to combat the rising cost of health care; the thought was that Medicare was being overcharged because it was willing to pay. Medicare's prospective payment system was instituted to deliver a fair, not bloated, recompense to doctors and hospitals. Beyond the frequent charge that these regulations have reduced the quality of care received by our elderly, there is also evidence that this plan is actually driving up health insurance prices--some say by as much as 20 percent--for all other consumers.

Aside from the cost-shifting and medical liability problems, health care costs will continue to rise because the public will continue to receive more and more new treatment as that treatment becomes more and more convenient and effective and continues to be paid for by someone else. The fact is that, for the insured, there is almost no consumer sensitivity at the point of demand. There is no incentive for the insured to shop for a better price or to

reject painless care that may be unnecessary. The fact is that real and meaningful cost containment will involve requiring those who can afford it to pay an increasing share of their health care bills (as distinct from their premiums, which would cause no decrease in aggregate health care costs).

Essentially, as we move into the Twenty-First Century, aggregate health care is becoming more expensive because there is becoming more of it. For so long as insurance continues to pay for new procedures--ever increasing in numbers--its price will continue to rise, and fewer Americans will be able to afford it. In order to cope with this problem, insurers are requiring advance approval for surgery and Medicare has adopted a new method of restricting unnecessary stays. Nevertheless, health care has risen from 10.4% to 11.1% of national GNP since 1985; in 1965, it was 5.9%. The ultimate solution may involve rationing health care. Many types of care--presumably the least necessary--may be denied. Otherwise, the high-tech medicine that has been such a boon to so many sick may become an economic bust of superfluous care.

Small Business Access to Health Care

Small businesses tend to provide a lower level of health insurance to their employees than larger businesses. The simple reasons for this disparity are high health care costs and, frequently, low small business profitability. The latter problem

has little to do with health care directly, so instead we will focus on the former. There are some unique problems for small business in the health insurance market; we need to understand them and what they are before we can recommend better solutions.

Insurance premiums are higher for smaller companies than for their larger counterparts because they have fewer employees over which to spread the risk. The workforce employed by these small firms is, in itself, a problem. Small businesses employ a disproportionate number of older workers, part-time workers, and women--all of whom tend to have higher-than-average insurance premiums. Further, the employees of the smallest firms must endure an individual underwriting process. Each employee's health record is investigated in order to determine, individually, the appropriate level for premiums. The cost of running these analyses is also then passed on to the consumer in the form of higher premiums. Such individual underwriting is not necessary for larger businesses with significant numbers of employees.

To illustrate the gravity of the problem, an analysis by the Health Insurance Association of America has estimated that employers with fewer than 25 employees pay 30%-40% higher premiums than employers with more than 25 employees, and the General Accounting Office (the GAO) reports that the premiums for those employers continue to rise at a rate 50% greater than the rate of increase for all other employers. Therefore, the problem is not

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simply that all insurance--even that of large corporations--is too expensive (though it is); the problem is that small, marginal companies actually get a substantial (and very discriminatory) price hike.

The major reasons for this disparity, says the insurance industry, are acquisition costs, administrative costs, and the low renewal rate among small firms. Insurers' marketing costs are higher per business (because there are so many small businesses to which to market, and so few who actually buy from any particular company) and must be repeated more often because of a low rate of renewal. There are also many other overhead, administrative costs which are higher for smaller firms, such as tracking of employees, maintenance of accounts, billing, and collection. The insurers claim that the major way to reduce these costs is to increase the size of the risk pool, yet through their rapid retreat from a community rating system, they are the ones who are segmenting that larger pool.

Moreover, due to the expiration of pre-existing condition provisions, insurance companies consistently raise rates in the second year of a plan. Premiums are also often raised if new employee conditions become present. These price-hikes in the out years--which are a direct result of the individual rating system and its pre-existing condition provisions--cause employers to switch insurance companies (when they can) with great frequency.

This effect (called "churning") accounts for a large part of what the insurance companies say is the high administrative cost of small business insurance. But this churning effect is a direct result of the pricing policies of these insurance providers.

In order to correct these inequities, we must take steps now to move back to a less discriminatory and a broader based system and move away from the current individually rated system for small business. This would end many of the problems with uninsurables and pre-existing conditions. Small businesses need to be allowed to operate within large risk pools in the same way which large businesses do. The current system of individually rating and segmenting the small business market throws any group-risk pooling arrangement out the window.

Smaller employers are lacking in other resources that are at the disposal of larger employers. Probably the foremost among them is the ability of large employers to negotiate with health care providers to receive special deals and rate reductions. These large corporations have the ability, for instance, to self-insure (a move which further reduces their costs in-and-of itself) and approach a health care provider and agree to pay all bills within a fixed time period in exchange for a reduction in the total bill. Small employers do not have the market power to negotiate this sort of a special arrangement.

It is indeed ironic that it has largely been bigger businesses that have complained about the impact of cost shifting on their bottom lines. These big businesses have suggested that, if more small businesses insured more of their employees, health insurance costs would not be shifted to big businesses. It is ironic because the only employers who are paying the full cost of their health care, who are not receiving special deals, who are the hardest hit by cost shifting are small employers. Perhaps if larger businesses paid the real, unreduced, costs of their health care bills, cost to small employers could be reduced to the point where many more of them could afford to provide health care for their employees.

Solutions

All of these circumstances lead us to the conclusion that the most essential problem of small business with regard to health care is a lack of market power, which is a function of size. Generally, the federal ERISA law does not allow heterogeneous businesses to group together to purchase insurance or to self-insure and deal directly with health care providers. To solve their unique problems, the small employers in a building, on a block, of a city or state should be allowed to consort to buy insurance. The greatly expanded creation of Multi-Employer Trusts (METs) would be a major step forward in giving small employers the necessary flexibility to be a discriminating consumer.

Benefits mandated by the individual states also discourage the extension of benefits. The states have laws requiring that specific health benefits be included in all employee insurance packages offered--often dramatically increasing the cost of coverage from what it would have been without that coverage. Further, these mandates drive up costs by requiring a term of coverage for former employees, increasing not only real cost, but also the aggregate administrative cost. If employers cannot attain this level or sort of coverage, it is illegal for them to provide any coverage at all. This sort of mandate prevents small employers from starting a plan in the first place (since even new plans cannot be, for instance, just major medical insurance), and it works strongly toward the cancellation of any plans that may be in effect. A 1988 study by the National Center for Policy Analysis has suggested that the number of people nation-wide who are prevented from receiving coverage as a direct result of these sorts of state regulations could be as high as 9.3 million--25% of the uninsured.

ERISA was designed to supercede these state mandates. However, in 1985, the Supreme Court ruled that the McCarran-Ferguson Act of 1945 still allowed states to regulate insured benefit plans ("the business of insurance"). The court did, however, agree that ERISA protects self-insured plans. Hence, for the large employers who can afford it, the trend toward self-insurance. Only small employers, already having the least means

and the highest insurance premiums are left to face the high costs of state mandates. Also, private insurance companies continue to charge ever-increasing rates as their risk-pools disappear into the self-insured market.

The unique circumstances of individual underwriting faced by small employers also allows (creates) a problem that is of great concern to many small businesses: the lack of insurance for those with "pre-existing conditions." Some suggest that if individual underwriting were made an illegal condition for the insurance industry to impose upon small businesses, the industry would be forced to consider its clients as a larger pool. The cost of those with pre-existing conditions would then be spread across that pool. No longer would insurance companies simply charge outrageous rates for certain individuals--or even deny insurance to an entire business because of a single employee. Under such a plan, employers would also be less likely to switch carriers with high frequency, because their prices would be more stable and uniform. Individuals with very grave conditions could be transferred to state-run pools for the uninsurable, spreading the cost to society at large.

NSBU supports the establishment of risk-pools to insure those individuals who are otherwise uninsurable. Subsidized risk pools may also be a viable option for insuring low income individuals. We oppose, however, the establishment of risk-pools which are

funded exclusively by employer assessments via taxes on insurance carriers. Even if the cost were spread across all businesses, the cost to small business of insuring otherwise uninsurable individuals would be enormous, but current laws would exempt self-insured plans from such an assessment, leaving half the insurance plans--predominately small business plans--to foot the entire bill. The best way to finance such a risk pooling is through the broadest possible tax base. A system financed by general funds (and, at some level, by the employer of the individual) and aimed at the uninsurable could well be an acceptable alternative and a big step forward in the health care debate. After all, these uninsurable individuals represent a societal problem, not simply a small business one.

The Pepper Commission Recommendations

The Pepper Commission recommendations contained a great deal of both good and bad elements for small business. On the one hand, the Commission would create an employer mandate which would simply be devastating for small business. Our analysis shows that, by the fifth year of the plan (the year in which the mandate would be universal), total additional insurance costs for small employers could be close to $40 billion per year. This is a clearly unacceptable alternative which is bad economic and health policy.

On the other hand, the Commission has proposed several dramatic reforms to the health care market and the insurance industry which would be very helpful for small business and which deserve strong support. Most of their reforms follow on NSBU's long-standing recommendations, which I have just spelled out above. Specifically, the Pepper Commission would: 1) move to a community rated system for insurance. This move would eliminate medical screening and health underwriting practices which limit or prohibit coverage on pre-existing conditions; 2) preempt state mandates by creating a more restrictive federal benefits package; and 3) fairly set the deductibility of all employer-provided health insurance at 100% for all employers.

One of the other major failings of the Pepper Commission was its lack of significant suggestions concerning medical liability reform and overall cost containment (as opposed to mere cost redistribution). The Commission in no way addressed the causes of our sky-rocketing health care costs; they only addressed the insurance side of the picture. We believe that one of the areas they could have immediately identified for reform--and suggested specific solutions for--was the area of medical liability. The Commission mentioned the problem and simply suggested that another Commission should address it. Much more needs to be done.

The insurance reform section of the Pepper Commission recommendations should be allowed to rapidly move forward in the health care debate. Such reform would not cost the federal Treasury any money, yet it would dramatically improve the ability of many small businesses to compete effectively in the health insurance market and properly insure their employees.

II. Payroll Taxes

Over the last several years, payroll taxes have been a popular area for increasing taxes. The payroll tax is a tax that the taxpayer does not directly see, at least not in its entirety. At first glance, it may seem to be a highly equitable method of taxation. The unemployed are not taxed, and larger businesses with more employees and taxed more than smaller businesses with fewer employees.

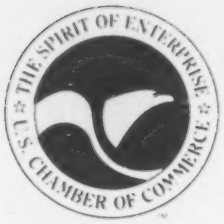
The obvious problem, of course, is that a payroll tax amounts to a tax on employment. Taxing businesses for hiring an employee clearly discourages increased employment, crippling the chances of the low-skill unemployed to find work; and, in the long run, this effect is very detrimental to the overall productivity of the business, and the American economy. But beyond these obvious economic problems associated with payroll taxes, there are also problems of fairness. Most small businesses are much more labor intensive than their larger counterparts. Payroll taxes cause

these small businesses to be taxed at a higher effective rate that the larger, more capital-intensive firms. This form of taxation is clearly regressive.

One of the real dangers of the payroll tax is that it is a tax which has been very popular to raise. This burdensome tax now constitutes more than one third of all federal revenue collections. From 1970 to 1990, business received nine Social Security (FICA) tax increases totaling 60%, three unemployment (FUTA) increases totaling 94%, three FUTA base increases totaling 133%, and 19 FICA base increases totaling 677%. With this kind of burden falling disproportionately on the backs of small business, further increases would be intolerable.

Payroll taxes essentially discourage businesses from expanding, hiring new employees, and giving many poor their first chances at on-the-job training and meaningful experience. At the same time, payroll taxes force the poorest individuals and businesses to pay higher effective tax rates than their more successful and larger counterparts.

We appreciate the opportunity to testify before you today concerning these important issues. We hope that we can now move forward toward meaningful solutions to these problems. If we can be of any further assistance to you, please do not hesitate to call upon us. As always, we appreciate your efforts.



Statement of the U.S. Chamber of Commerce

ON: PAYROLL TAXES, HEALTH CARE AND HEALTH INSURANCE

TO: HOUSE SMALL BUSINESS COMMITTEE

BY: FRANK MASON

DATE: MARCH 29, 1990

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is the world's largest federation of business companies and associations and is the principal spokesman for the American business community. It represents nearly 180,000 businesses and organizations, such as local/state chambers of commerce and trade/professional associations.

More than 93 percent of the Chamber's members are small business firms with fewer than 100 employees, 45 percent with fewer than 10 employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business--manufacturing, retailing, services, construction, wholesaling, and finance--numbers more than 10,000 members. Yet no one group constitutes as much as 32 percent of the total membership. Further, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the 59 American Chambers of Commerce Abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross section of its members serving on committees, subcommittees and task forces. Currently, some 1,800 business people participate in this process.

STATEMENT
on
PAYROLL TAXES, HEALTH CARE AND HEALTH INSURANCE
before the
HOUSE SMALL BUSINESS COMMITTEE
for the
U.S. CHAMBER OF COMMERCE
by
Frank Mason
March 29, 1990

Good morning, Mr. Chairman and members of the Committee. My name is Frank Mason, and I am testifying on behalf of the U.S. Chamber of Commerce. I am a member of the Chamber's Health and Employee Benefits Committee, a former member of its Board of Directors, and Chairman of the Board of the Mason Corporation in Birmingham, Alabama. With me is Christine Russell, director of the Chamber's Small Business Center.

The Chamber wishes to thank the Committee for the opportunity to present its views on these issues of great importance to small business.

I. Payroll Taxes

1. Social Security

In 1986, I led the Alabama delegation to the White House Conference on Small Business, and I was part of a group that looked at the area of payroll taxes. One of our recommendations, which emerged as the number 8 priority of the entire conference, concerned Social Security. We called for a freeze on the tax rate and the wage base at 1986 levels and suggested further reductions in the tax rate as well as the exploration of long-range alternatives to the present Social Security system, which places an undue and inequitable financial burden on businesses and their employees. The Chamber endorsed this recommendation.

As we are all aware, no freeze occurred. Social Security (FICA) taxes have risen twice since then. From 1980 to 1990, the basic payroll-tax rate rose from 6.13 percent to 7.65 percent, an increase of 25 percent. Over the same period, the taxable wage base expanded from $25,900 to $51,300. Combined, the two factors are responsible for more than doubling (from $1,588 to $3,924) the maximum tax paid by employees and matched by businesses. The maximum tax paid by a self-employed individual rose from $2,098 in 1980 to $7,849 in 1990.

The result of this escalation is that the Social Security system is now taking more in taxes than it needs to pay for current benefits. It has recently been highlighted that these excess taxes are not being saved for the proverbial rainy day. Instead, they are borrowed by the Treasury and used to finance current spending.

The Chamber's 1989 Employee Benefits Survey found that employer FICA taxes account for 18.6 percent of all benefit dollars spent. This figure is based on a sample of businesses of all sizes. For small business, which frequently cannot afford to sponsor pension and welfare benefit plans, the proportion of available benefit dollars consumed by FICA taxes is much higher.

The FICA tax burden falls heavily on small business for a number of reasons. Small businesses generally are more labor-intensive than larger firms, and their average wages are lower. With a FICA taxable wage base set at $51,300, it is likely that virtually every dollar paid out in wages by a small employer carries an automatic surcharge of 7.65 cents.

Small business was responsible for more than 60 percent of new job creation in the U.S. in the 1980s. But pressures restraining job creation continue to mount, and

higher Social Security taxes must be considered as an element in that process. High payroll taxes add to the marginal disincentives to expand one's work force. A combined employer-employee FICA tax rate of 15.3 percent means that any job must be worth at least 15.3 percent more to the employer than it pays to the employee before anyone is hired. This weighting will be compounded in April, when an increase in the minimum wage drives up direct employment costs and their attendant tax encumbrances.

Unlike income taxes, payroll taxes have no relation to a company's profitability. They must be paid from day one, whether a business is flourishing or floundering. Consequently, high payroll taxes constrain not only employment but also overall financial capacity, particularly for small firms. For labor-intensive businesses, high tax rates compound the difficulties of effectively competing at home and in international markets.

Small business has been a willing participant in the Social Security system. The employer's contribution to Social Security may constitute the bulk -- or indeed the whole -- contribution he can afford to make to national retirement protection. However, that portion of tax monies spent to finance current spending protects no one. The business owner quite reasonably could feel that his dollars would more properly be invested in his operation and his employees than in paying the government's bills.

The Chamber strongly believes that it is desirable to reduce the Social Security tax rate and the general burden of taxation -- as well as the growth rate in government spending. Therefore, the Chamber urges Congress to reduce the Social Security payroll tax, matched by a reduction in expenditures necessary to meet Gramm-Rudman-Hollings deficit reduction targets without increasing other taxes.

2. Federal Unemployment Tax Act (FUTA) Taxes

The FUTA tax is imposed on employers to pay for the normal administration of unemployment insurance (UI) and employment service (ES) programs. These are not general revenue funds and their use is legislatively restricted to the purpose for which they were imposed. Although adequate revenue is being generated to support these services, it is not being fully allocated. In Fiscal Year (FY) 1990, The Department of Labor estimates that $710 million more will be collected under FUTA for administration than will be expended. For FY 1991, the President's budget calls for $2.93 billion in outlays for administration, although the corresponding revenues are estimated at $3.64 billion -- a difference of $710 million. It is difficult for employers, workers and administrators to understand why the system must face nearly three-quarters of a billion dollars more in federal unemployment taxes in FY 1990 than the Administration plans to spend for UI and ES programs.

The failure to allocate the available funds has forced many states to supplement federal funds received for the employment security system with state funds. In 1989, the Interstate Conference of Employment Security Agencies found that 35 states had appropriated state general revenues or enacted state payroll taxes for UI and ES administration. Such funds are considered essential to keep these services operating at a level to meet minimal state needs. This is a case of unjustifiable double taxation. Employers, and ultimately the public, are paying twice for employment security services in these states.

The Chamber contends that payroll taxes imposed for a specific purpose should be used for that purpose or rescinded.

3. Payroll Deposit System

One of the biggest complaints that small businesses have with the Tax Code involves payroll tax compliance. These are the rules which require firms to deposit Social Security taxes and income tax withholdings with an authorized bank depository, which serves as the tax collection vehicle for the federal government.

Small Business is generally more labor intensive than medium and large businesses. It is for this reason that payroll taxes are likely to impose a higher burden of compliance on smaller firms than other provisions of the Tax Code.

In general, a business is required to make payroll tax deposits as often as it pays its staff, which could be as often as eight times a month. This particular rule could apply to an employer who owes $3,000 or more in payroll deposits during the month. There are various other payroll deposit rules which are extremely complex and which pose a significant compliance burden for small and large businesses alike. The Chamber strongly recommends that the overall payroll tax depository system be simplified, as this would help to lessen the compliance burdens of the business community.

In addition to the complexities of the overall payroll deposit system, small firms have also been traditionally concerned about the harshness of the penalties associated with a payroll deposit payment which has (likely for inadvertent reasons) been made late with an authorized bank depository.

The FY 1990 budget reconciliation legislation did take positive steps to reduce the complexity of payroll tax penalties. Under the new law, a small business person could be subject to a system of graduated penalties assessed according to the degree of lateness of the payroll deposit. The Chamber is generally supportive of the new

graduated payroll deposit rules, except for the implementation of a 15 percent penalty (the highest level penalty under the graduated structure). It is the Chamber's view that there is little policy justification for the 15 percent penalty and that the procedural mechanics of the 15 percent penalty are extremely onerous in application. This particular aspect of the payroll deposit penalty rules should be reviewed by the Congress.

II. Health Care and Health Insurance

1. Health Insurance for Small Business

The problems of spiraling health care costs and growing gaps in health coverage have been well-documented in recent years. The plight of small business in the health insurance marketplace has not.

According the to the Census Bureau, 13 million of the approximately 31 million Americans who lack health insurance are full-time, full-year employees and their dependents. More than 43 percent of the employed uninsured work for firms with fewer than 25 employees.

Most small employers want to offer health insurance to their employees. But many currently find health insurance difficult or nearly impossible to obtain -- or completely unaffordable.

Medical cost inflation has taken its toll. Overall, businesses currently face annual health care cost increases averaging 20 percent, with many small businesses hit with increases of 40 percent or more. Since 1980, employer-paid insurance costs have risen dramatically.

Administrative, marketing and brokerage costs add 25 to 40 percent to the cost of health insurance premiums for small businesses. These costs are higher for small businesses because the insurance carrier or agent may have to perform administrative or claims management functions handled internally by a larger client.

Small businesses face other obstacles as well. First, small employers usually do not have easy access to managed care plans, which have been successful in restraining costs. Managed care options include health maintenance organizations, inwhich provide all health services to members for a flat fee, and preferred provider organizations, in which affiliated medical practitioners provide services at a discount. HMOs often do not write accounts for companies with fewer than 25 employees. In addition, many insurance carriers do no offer benefit plans with aggressive managed care features to their small business customers.

Second, current tax laws discriminate against self-employed (primarily small) business owners by allowing only a 25 percent deduction for their health insurance expenses, while corporations may deduct 100 percent of their health expenses.

Third, small business employers do not have sufficient assets to self-insure their health care risks. These companies must purchase insured plans, which are regulated at the state level. State mandated benefit laws require carriers to include benefits that add an estimated 20 percent to the cost of health plans in some states.

Finally, the increasing trend toward self-insurance by medium to large firms has forced health insurance companies to maximize their profits in the small group market. The forces of very tough competition in the health insurance industry are driving insurance companies to stricter underwriting practices for small business.

Underwriting is how insurers determine who they will cover. Insurers often segregate workers considered to be "high risks" from group rates and price them separately or exclude preexisting health conditions.

Insurance companies compete on the basis of risk selection. The statistics underscore the reasons. Approximately 5 percent of the U.S. population accounts for about 50 percent of national health expenditures; 20 percent accounts for about 80 percent of the expenditures. Therefore, who is in an insurance company's risk pool is critical to that insurer's profitability.

An insurer which has a high risk clientele and must charge more than its competitors becomes less competitive; moreover, it attracts more of the higher risks who cannot obtain coverage elsewhere. Such a company will end up with expensive "demographic sludge" and pay more in claims than is covered by premiums. This has happened to several carriers in recent years, forcing some out of business. In short, competitively forced underwriting is destroying the insurance market for small businesses.

In an environment where there is no constraint on the risk-selection process, one cannot expect an insurance carrier to sell insurance policies for social policy reasons that will destroy it in the marketplace.

The insurance industry collectively must constrain the underwriting practices that have contributed to this problem. We must return to the traditional concept of insurance -- the broad spreading of risk across a wide population. Specifically, insurers in the small business market should:

- accept all employees when providing group coverage to a company;
- guarantee renewal of a group at pooled rates, once the group has been accepted;

- impose no new preexisting condition limitations on an individual who has been continuously insured, when that person changes employment or coverage; and
- provide a reinsurance pooling mechanism to provide direct access to small employers who otherwise have been rejected and to spread risks among participating insurers and HMOs.

These changes can be accomplished, but federal legislative or regulatory action likely will be necessary since voluntary compliance should not be expected in today's highly competitive environment. The small business community is willing to work with the insurance industry to achieve these reforms. These are positive steps that can be taken right now to help a significant portion of the uninsured population -- the working uninsured.

Failure to act will give impetus to two equally unpalatable "cures" for our health care woes -- congressional mandates for employers to provide health insurance (no matter what the cost) and national health insurance. We can and should do better.

Attached as appendix I, please find a copy of a statement on access to health care adopted by the Chamber's board of directors that sets forth our recommendations in this area. These are difficult issues and our position will continue to evolve as we attempt to craft positive solutions to the problems before us.

III. The Pepper Commission

On March 2, 1990, the Pepper Commission released its recommendations for addressing the problem of the growing gaps in health coverage. Attached as appendix II, please find a copy of our letter to the Pepper Commission outlining in more detail our

specific recommendations. The commission's recommendations are a mixed bag. We are disappointed by the emphasis on mandated benefits as a solution to the access problem. Despite the best efforts of the commission to ameliorate the impact of mandates on small business, the fact remains that mandates will cause job loss and will hurt those they purport to help. We are pleased that the commission recognizes the need for market reforms, similar to those described above. The Chamber first advanced such reforms at a hearing before the Subcommittee on Health And The Environment of the House Committee on Energy and Commerce on October 16, 1989. We also are pleased to note that the Health Insurance Association of America recently approved a similar set of recommendations.

The Pepper Commission recommendations provide a starting point for discussion and will aid in the continuing refinement of these issues in order to better determine the areas of consensus and disagreement. We must move forward in those areas where consensus exists.

IV. Conclusion

The Chamber thanks the Committee for its attention and particularly wishes to thank you, Mr. Chairman, for holding these important hearings. I would be happy to answer any questions you may have.

APPENDIX I

U.S. Chamber of Commerce

Washington, D.C. 20062

STATEMENT ON ACCESS TO HEALTH CARE

I. COMMITMENT TO AN INITIATIVE ON COST, QUALITY AND ACCESS

A policy goal of the U.S. Chamber of Commerce is to increase financial access to health care, constrain health care costs and enhance quality. As health care costs climb nationally, the issue of financial access to care is inextricably linked with the issues of costs and quality. These three issues must be dealt with in tandem in order to forge a consensus of payors, providers and consumers.

II. GOAL: REDUCE THE NUMBER OF UNINSURED PERSONS BY TWO-THIRDS TO THREE-QUARTERS WITHIN A REASONABLE PERIOD OF TIME, AS PART OF A LONG-TERM COMMITMENT TO UNIVERSAL FINANCIAL ACCESS TO CARE

The Chamber supports, as a long-term goal, a system of public and private insurance that would assure universal financial access to appropriate health care. Even while the nation searches for the means to achieve that long-term goal, the Chamber supports immediate action to lessen the number of uninsured through a mix of public and private initiatives. A reasonable target for such short-term steps would be to reduce the number of uninsured by two-thirds to three-quarters within a reasonable period of time. Such an effort will require a partnership of the public and private sectors with neither sector asked to undertake financing burdens more appropriate to the other.

III. PROPOSAL: EXPAND MEDICAID TO ADDRESS THE NEEDS OF THE POOR AND NEAR-POOR

Approximately 32 percent of the uninsured population is poor -- defined as those with incomes below the federal poverty level. Currently, only 40 percent of Americans with incomes below the poverty line receive assistance from the Medicaid program. Differing state priorities and a growing elderly population with chronic care and nursing home needs have diluted the effect of this federal/state program originally designed to increase access to basic health care for the indigent. The U.S. Chamber of Commerce supports a four-part plan to address the health care needs of the poor and near-poor who do not have financial access to primary care coverage:

A. Assure basic Medicaid coverage to all Americans with incomes below the federal poverty level, restoring the original intent of this program and defining clearly the public sector's responsibility.

B. Allow persons with incomes between 100 and 150 percent of the federal poverty level to purchase, for a sliding-scale premium, primary care coverage through Medicaid.

C. Permit persons with incomes above the poverty level who have large medical expenses to "spend down" and become eligible to receive full Medicaid coverage once income is reduced to the federal poverty level.

D. To ease an individual's transition from welfare or Medicaid, provide states the option of paying Medicaid-eligible employees' share of premium and other costs where private employer-based coverage is available.

In recognition of state and federal budget constraints, the Chamber supports various options for phasing-in expanded Medicaid coverage, within the following priorities:

– Mothers and children, with the youngest children receiving greatest priority;

– Phase up medical eligibility by percentage of poverty level, beginning with the "poorest poor";

– Primary care coverage.

IV. PROPOSAL: PROVIDE ACCESS TO STATE POOLS FOR HIGH RISK INDIVIDUALS

A small but socially significant percent of the uninsured population is comprised of nonpoor persons who are unable to purchase private health insurance because they are substandard health risks. The U.S. Chamber of Commerce supports federal legislation which would require establishment of state pools for uninsurable individuals, with losses financed by state general revenues or other broad based funding. Thus far, 16 states have established such risk pools.

V. PROPOSAL: PROMOTE EXPANDED VOLUNTARY COVERAGE THROUGH THE WORKPLACE

Approximately two-thirds of the uninsured population has some nexus to the workplace (i.e. workers, spouses or dependents). The problem among this population is especially prevalent within the small business sector where normal insurance administrative and underwriting mechanisms can make affordable insurance difficult to obtain. The Chamber is committed to finding ways to extend private, voluntary insurance coverage without at the same time producing job loss. Part of this effort must involve creating cost containment and quality improvement inducements that will encourage employers to expand coverage. The Chamber supports the following specific proposals:

A. Self-employed persons and unicorporated firms should be given a 100 percent deduction for health benefits costs. Unincorporated firms are about half as likely as other companies to provide health care coverage to owners and workers.

Currently, these firms may deduct only 25 percent of these costs and even this deduction will lapse at the end of 1989.

B. Multiple Employer Trust (MET) arrangements should be encouraged. These are group arrangements formed to help small firms obtain health care coverage on a more cost-effective basis than such a firm might be able to achieve alone. Use of improved cost containment, quality and appropriateness methods in these programs can make them affordable to larger cross section of employers. However, numerous federal and state regulatory impediments have discouraged the proliferation of these arrangements. If necessary, such impediments should be preempted by federal action.

C. The private health insurance and HMO industries must make special efforts to guarantee the availability of affordable health insurance to small businesses. To that end, insurance underwriting practices that prevent the pooling of good and bad risks within small employer pools must be constrained. Specifically, the insurance and HMO industries should give consideration to: (a) limiting medical underwriting of individuals within a firm (so that the whole group is accepted or not); (b) guaranteeing renewal of a group, at pooled rates, once it has been accepted (no renewal underwriting); (c) imposing no new pre-existing conditions on an individual who has been continuously insured if such individual is changing employment or coverage; and (d) providing a reinsurance pooling mechanism to spread risks among participating insurers and HMOs and to provide direct access to small employers who have otherwise been rejected. Any losses from such a reinsurance pool should be shared fairly based on who benefits from the mechanism.

D. State-level benefit mandates and barriers to managed care programs should be preempted. More than 640 specific state mandates now require insurers to include particular benefits in health plans. (e.g., mental health or chiropractic coverages) which make insurance more costly to employers with insured plans.

There is increasing legislative activity at the state level which has the effect of undercutting cost-containment efforts by limiting managed care arrangements. This involves such measures as limitations on the ability to form preferred provider arrangements or to provide economic incentives to employees to select such arrangements. Such barriers to managed care should be removed by federal or state action.

E. Federal benefit mandates (e.g., Section 89, COBRA) should be repealed or simplified for employers.

VI. PROPOSAL: PROMOTE THE DEVELOPMENT OF NATIONAL MEDICAL PRACTICE STANDARDS TO ASSURE APPROPRIATE AND EFFECTIVE CARE

A significant percentage of services delivered in our health care system are judged by researchers to be either inappropriate or ineffective. Further, research has shown wide variations in the use of procedures across different geographic regions with no apparent medical justification. The development of practice guidelines, review protocols and outcomes-based assessments through a national effort led by physicians and scientists is the key to removing this degree of waste from the system. Use of such standards with due care by physicians should carry with it protection from unwarranted malpractice claims. The Chamber therefore supports:

A. A national medical-scientific effort, supported by expanded Federal funding, to develop and implement national medical practice standards; and

B. Tying the use of such standards by physicians to protection from malpractice claims under state law, provided the physician has used due care in their application.

APPROVED BY THE BOARD OF DIRECTORS JUNE 14, 1989
REVISED NOVEMBER 8, 1989

APPENDIX II

CHAMBER OF COMMERCE
OF THE
UNITED STATES OF AMERICA

RICHARD L. LESHER
PRESIDENT

1615 H STREET N.W.
WASHINGTON D.C. 20062
202/463-5300

February 16, 1990

The Honorable John D. Rockefeller IV
Chairman
The Pepper Commission
140 Cannon House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

The U.S. Chamber of Commerce, the world's largest federation of businesses, chambers of commerce and trade and professional associations, offers its views on solutions to provide access to health care for all Americans.

The Chamber seeks to assure universal financial access to appropriate health care for all Americans and their families. As health care costs climb, the issue of access to health care has become inextricably linked with the issues of cost and quality. The Chamber believes that these three issues must be addressed in tandem in order to forge a consensus on a workable solution. Such an effort will require a partnership of the public and private sectors, with neither sector being asked to absorb financial burdens more appropriate to the other.

A number of approaches have been proposed to address the problem of the growing number of Americans without health insurance. Because the uninsured population is diverse, no single solution is appropriate. For example, requiring all employers to provide a specified package of benefits does not take into consideration the factors -- primarily the high cost -- that have prevented some businesses from providing coverage or the perverse consequences that mandating benefits could have for many of the working poor. A tax-based "play or pay" mandate would have the same devastating effect on many small businesses -- an impact that cannot be discounted.

The Chamber believes that a multifaceted approach to health care reform should be developed and supports immediate action to lessen the number of uninsured individuals through a mix of public and private initiatives. In this regard, the Chamber's Board of Directors has approved a policy statement embracing several specific recommendations. I enclose a copy of this Statement on Access to Health Care and would like to highlight the importance and relevance of these recommendations.

The data on the uninsured population reveal that most employed uninsured individuals work in small businesses. Given the obstacles small businesses face in purchasing health insurance that is not surprising. Health care premiums for small businesses run 15-20 percent higher per employee than for larger businesses. Factors that make health insurance more costly for small businesses include medical underwriting, higher administrative costs, lack of market clout to insist on group rates and an inability to self insure.

Businesses with 100 or fewer employees comprise 90 percent of the Chamber's membership, and we have heard from hundreds of business owners on this issue. Most indicate that they currently do or want to offer health coverage but increasingly are finding it beyond their reach. Obviously, the issue of cost cannot be separated from the issue of access.

Fortunately, there are positive steps that can be taken to make affordable health insurance more available for small businesses:

o **Preemption of state benefit mandates.** Nearly 700 benefit mandates in the states require insurers to include specific benefits in health plans. One rationale for the benefit mandates is to ensure access to the services of alternative providers. But the practical result has been increased premium costs for businesses who purchase insured health plans -- primarily small businesses. It also has had the effect of driving those businesses with adequate financial resources to self insure their health risks in order to escape this burden. Consider the statistics: In 1980, fewer than 10 percent of employer-provided health plans were self insured. Today, 55 to 60 percent of employer plans are self insured. The Chamber supports preemption of state benefit mandates under the Employee Retirement Income Security Act.

o 100 percent deduction for health insurance expenses of self-employed individuals. Self-employed small business owners may deduct only 25 percent of their health insurance expenses, while incorporated businesses may deduct 100 percent. The fact that health insurance is not fully deductible for the self-employed is certainly one major reason why that group of businesses is the least likely to purchase or offer health insurance. [redacted] The Chamber supports [redacted]

o **Reform of the small group health insurance market.** The forces of very tough competition in the health insurance industry are driving carriers to stricter underwriting practices for small businesses. Indeed, even certain classes of businesses and occupations have been blacklisted from coverage. The resulting market segmentation is particularly insidious for small businesses because they are not large enough to average out healthy workers with high-expense workers and do not have the market clout to insist upon group rates and equal coverage for their employees.

The Chamber believes that we must return to the traditional concept of insurance -- the broad spreading of risk. To achieve this goal, insurers should accept all employees when providing group coverage to a company; guarantee renewal of a group at pooled rates; impose no new pre-existing condition limitations on individuals who have been continuously insured, even when changing employment or coverage; and provide a reinsurance pooling mechanism so that small employers who have otherwise been rejected have direct access to coverage.

In addition, individuals who are unable to purchase private health insurance because they are substandard health risks face special problems. The Chamber believes that nonpoor individuals who are medically uninsurable should be able to purchase health insurance through state pools, with losses financed by state general revenues or other broad-based funding.

o **Encouragement of small group pooling arrangements.** Group pooling arrangements help small firms obtain health care coverage on a more cost-effective basis than an individual firm might be able to obtain it. However, confusion exists over the regulatory status of certain pooling arrangements, known as multiple employer welfare arrangements (MEWAs); the Chamber believes that this should be clarified.

o **Address factors driving health care inflation.** The reasons for the inflationary spiral are complex, ranging from the aging of our population to the litigiousness of the society in which we live. While the demographic trends are a given, there are steps that can and should be taken to address other factors, including the degree of waste resulting from defensive medical practices. The Chamber supports the development of national medical practice standards and is pleased that this effort will be spearheaded through the newly-created Agency for Health Care Policy and Research. We believe that this process should be taken one step further, with the use of such standards tied to protection from malpractice claims under state law, provided the physician has used due care in their application.

In addition to these reforms, we must ensure that the public sector meets the health care needs of the indigent. Currently, 11 million Americans with incomes below the poverty level do not qualify for coverage under Medicaid. The Chamber supports expansion of the Medicaid program so that all Americans with incomes below the federal poverty level are assured coverage. The Chamber also believes that provisions should be made for the near poor to ensure that uninsured individuals on the fringes of the workforce have financial access to coverage.

Admittedly, this is an incremental approach. But incrementalism should not be viewed as equivocation. We should move forward in those areas where there is broad consensus. To do less would be to consign this nation to the status quo for health care. Let me assure you that the business community does not want to maintain the status quo at a time when that means rapidly escalating costs, increasing questions about quality of care and a growing

uninsured population. At the same time, however, I must emphasize that the Chamber does not favor employer mandates or a national health insurance approach. Solutions should be market oriented, with government assuming responsibility for the indigent. Individuals, government and business must assume some obligations.

Health care is an issue of great importance to the business community. Mr. Chairman, the Chamber commends you for your leadership in this area and stands ready to assist you as you continue to work on these issues.

Sincerely,

Richard L. Lesher

cc: Members of the Pepper Commission

Enclosure

NFIB

National Federation of
Independent Business

STATEMENT OF

DAVID K. REHR

ASSISTANT DIRECTOR FOR

FEDERAL GOVERNMENTAL RELATIONS, HOUSE

NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Subject: Social Security FICA Tax and Health Care

Before: House Small Business Committee

Date: March 29, 1990

On behalf of the more than 500,000 small business members of the National Federation of Independent Business (NFIB), the largest small business advocacy organization, I am pleased to participate in this hearing. NFIB commends Chairman LaFalce for his foresight in holding these hearings to examine the enormous burden payroll taxes have become to business owners and in particular small businesses. We also appreciate the opportunity to testify concerning the issue of health care and its impact on small business. Our membership parallels the national business population in that approximately 50% of our members own retail and service enterprises; 25% are in manufacturing and construction; and the remaining 25% operate agricultural, transportation, mining, wholesale, financial, insurance, or real estate enterprises. The average NFIB member has 13 employees and grosses about $350,000 in annual sales.

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The Guardian of
Small Business

SOCIAL SECURITY FICA TAX

As you can see, our membership and small businesses in general are concentrated in those sectors of business which tend to be primarily labor intensive. They employ people rather than machines. Payroll taxes, dominated by FICA taxes, therefore place a disproportionate burden on them.

Mr. Chairman, the term FICA -- the Federal Insurance Contributions Act -- tax is as outdated as the term "trust funds." Webster defines trust as "the assured reliance on the character, ability, strength, or truth of someone or something." Sadly, in many small business owners' minds, the Social Security trust funds could better be defined as a "black hole" in which every day small business owners and working Americans throw their money, believing that they may well never see it again.

Unfortunately, the myth that the trust fund surplus is being saved for future retirees has been put forward at the expense of current beneficiaries of Social Security, small business owners, and other taxpaying Americans who expect to be able to draw on the reserve at retirement. In fact, these funds are going right back out the door to pay for current government services and current Social Security benefits while a mountain of IOUs are growing higher every day. As time goes on and the number of retirees increases proportionally to the number of workers, the need to take drastic action with regard to Social Security intensifies. The first and most obvious step is to stop the crushing tax increases which small business owners and working Americans are being forced to pay.

Legislative Proposals to Reduce FICA Taxes

To that end, NFIB applauds Senator Moynihan for his courage in introducing legislation to reduce the FICA tax rate. Senator Moynihan's proposal would repeal the FICA increase to the 1989 level of 6.06%, leaving the Medicare rate intact at 1.45%. My understanding is that his proposal would further reduce the 6.06% rate to 5.1% in 1991 and then begin to bring the rate back up again in 2012 to 5.6%, increasing to 8.1% in 2045.

Congressman Tim Penny has introduced similar legislation in the House. Specifically, Congressman Penny's legislation would rescind the FICA tax increase that went into effect on January 1, 1990 and further reduce the FICA tax in 1991 by 1.1 percent on both employees and employers. In effect, this legislation would reduce the FICA tax to its 1989 level of 6.06 percent from the current level of 6.2 percent. In 1991, the FICA tax would be further reduced to 5.1 percent.

Congressmen Dorgan and Durbin have also introduced legislation which would repeal the Social Security FICA tax increase which took effect January 1. In addition, their legislation would prohibit the use of Social Security trust fund reserves for deficit reduction. Rep. Hank Brown has introduced a similar proposal which would also rescind the 1990 payroll tax increase for employers and employees. Congressman Brown's legislation would immediately take Social Security off budget and establish an independent Social Security agency.

NFIB Position on Social Security FICA Tax Cuts

NFIB fully supports the provision in these proposals to immediately repeal the 1990 FICA tax increase which will provide small business owners and their employees much-needed relief from this regressive and unnecessary tax. We are working with Congressmen Penny, Dorgan, Durbin, and Brown to see that this rollback becomes a reality.

NFIB further supports a responsible way to further reduce FICA taxes to the levels suggested by Senator Moynihan and Congressman Penny while at the same time ensuring that Congress is not forced to raise taxes. To prevent this, a workable mechanism must be found -- such as the phased-in FICA tax reduction suggested by Senator Kasten -- which will allow Congress and the President to meet their deficit reduction obligations without raising taxes.

The need to reduce the FICA tax rate is of critical importance to NFIB and small business owners across the country for the following reasons:

Highest Tax

First, it's important to remember that small business owners pay significantly more in FICA taxes than income taxes. Small business owners must pay half of the 15.3 percent FICA tax for all their

employees. Self-employed business owners (unincorporated firms which represent approximately two-thirds of all businesses in the U.S.) must pay the entire 15.3 percent FICA levy. In 1980, an NFIB study indicated that payroll taxes, dominated by FICA, comprised more than 50 percent of the taxes paid by small business owners. This study analyzed the taxing provisions of 17 different states for 5 typical small businesses. The study revealed that for most small businesses, the greatest tax burden is not generally imposed at the income tax level -- either federal, state, or local. Instead, the most significant portion of the burden is the result of payroll and property taxes -- taxes which are not based on the profitability of the taxpayer, but rather the components of the business which generate the profits: facilities, equipment, and people.

In almost every case in the study cited above, payroll taxes comprised more than half of the total tax burden. Since 1980, income taxes have been slashed while the FICA tax rate has gone up 6 times, with an increase of 1.52 percentage points, from 6.13% in 1980 to 7.65% in 1990. Social Security tax revenue as a percent of total federal revenue rose by 23 percent from 1980 to 1988, while corporate and personal income tax revenue as a percent of total federal revenue declined by 23 percent and 6 percent respectively.

Startup and Marginal Small Businesses

The FICA tax burden discourages many individuals from pursuing the American dream of starting up a new small business because of the prohibitive cost of this tax. For those small businesses in trouble, struggling

to keep their doors open, the FICA tax burden can be the "last straw" before a business is forced to close down. The bottom line is that the Social Security FICA tax is a decidedly regressive tax; new and marginal businesses must pay the same rate as healthy businesses. The tax is not related to profitability.

Job Creation

Over 70% of the 17 million net new jobs created in this decade have been in small firms. Small business is now known as the nation's "job generator". According to the 1988 report to the President entitled The State of Small Business, 10.5 million net new jobs were created from 1980-1986, of which 63.5 percent or 6.6 million jobs came from firms with fewer than 500 employees. More than 4 million jobs were created in firms with fewer than 20 employees. More than half of all Americans working in the private sector are now employed in small businesses. More often than not, small businesses are also the place where young people receive their first full-time employment with its valuable on-the-job training. Small businesses also employ more older workers than do large businesses.

The FICA tax is a tax on labor and jobs because payroll tax payments must be paid "up front", regardless of profits, at least once a month by small business owners. This tax could prove fatal not only to small business owners who are heavily dependent on people, but also to the labor force. With payroll taxes continuing to grow, small businesses may not be able to hire as many individuals in the future; some small businesses may even have to close, displacing individuals in the labor market.

A recent IRET study estimated that a proposal such as Senator Kasten's to reduce the FICA rate to 5.3 percent by 1992 would add between 450,000 and 920,000 new jobs, raise GNP by almost $300 billion, and increase the capital stock by $180 billion.

Small Business Costs

Small businesses cannot pass on costs in the same way larger businesses can. The FICA tax therefore disproportionately disables small businesses and increases their costs. The 1986 White House Conference on Small Business called on Congress to freeze the employer FICA contribution wage base and tax rate at the 1986 rate. The recommendation in part urged Congress to develop long-range alternatives to the present Social Security system, which places an undue and inequitable escalating financial burden on businesses and their employees. Our own NFIB mandate survey for August 1987 revealed that an overwhelming 79 percent of small business owners favor repealing the 1988 and 1990 payroll tax increases.

Self-Employed Small Business Owners

While most small business owners must pay half of the 15.3 percent FICA tax, self-employed business owners must pay the full FICA tax payment ,which increased dramatically for these business owners from 13.02% in 1989 to 15.3% in 1990. According to a study by the Employment Benefits Research Institute (EBRI), self-employed business owners employ 32% of the American workforce. Considering that these business owners

must face a myriad of other challenges such as the inability to fully deduct their health insurance, the effect of the FICA tax increase is multiplied. Although in 1990 self-employed individuals may deduct one-half of their Social Security taxes, many will not be able to take advantage of it because they don't make enough money to pay taxes. The elimination of the 2% tax credit, combined with the increase in FICA taxes, therefore hits self-employed business owners especially hard.

Small Business Owners' Social Security Position Over Time

NFIB members have consistently expressed their strong opposition to any increase in payroll taxes. As I have already mentioned, NFIB recently asked its membership whether the payroll tax increase scheduled for 1988 and 1990 should be repealed. An overwhelming seventy-nine percent of our members voted against the tax increases. In fact, in the last fifteen years during the dramatic changes which have caused the Social Security system to be restructured, NFIB small business owners have consistently opposed the incremental Social Security FICA tax increases. Just prior to the Social Security crisis which precipitated passage of the 1983 Social Security Amendments, Michael Boskin, the President's Chairman of the Council of Economic Advisors, prepared a paper for NFIB in which he stated:

> "Given the huge outcry against the large (payroll tax) increase legislated in 1977 it is clear that the time has come to reexamine the future course of Social Security. The alternative is continued unpopular tax increases which add to costs and prices, reduce net wage rates, redirect the system further from an earned entitlements or annuity basis and continually erode public support of the Social Security system."

Small business owners agree with Mr. Boskin's assessment that the FICA tax increases "add to costs and prices, reduce net wage rates, redirect the system further from an earned entitlements or annuity basis and continually erode public support of the Social Security system". Although the environment in which Mr. Boskin was writing has changed, the basic premise still holds true that increasing FICA taxes only adds to the crushing tax burden of small businesses and doesn't begin to resolve the Social Security dilemma.

HEALTH INSURANCE AND SMALL BUSINESS

With regard to health insurance, Mr. Chairman, small business owners are the victims of a two-tiered problem: rising health care inflation, and rising health insurance premiums or the unavailability of insurance. Both have one common element -- cost. Cost restricts the access of small businesses and individuals to the system. Without affordable insurance premiums or affordable health care, access is a moot issue.

The most recent figure on the uninsured claims that 31.8 million individuals are uninsured. The breakdown of this population is illustrative. It suggests that there are distinct subsets within the uninsured population, each requiring different tactical approaches. A focus upon uninsured workers misses substantial portions of the uninsured population: unemployed, low-income, and children. The Pepper Commission failed in its mission by focusing upon a quick fix -- mandated benefits -- and ignoring the real, driving problem -- cost.

For small businesses and their employees, access is determined by cost. Cost also explains a recent phenomenon -- the slight decline in the number of small firms offering health insurance as a fringe benefit. Cost prevents new firms from offering health insurance and jeopardizes the continuation of existing health insurance benefits.

The cost of health insurance can be the greatest payroll line-item cost in a small business -- many times exceeding the combined cost of workers compensation and liability insurance. Exacerbating the problem, a majority of small firms pay 100% of the premium cost. These same businesses have little access to managed care or cost-containment measures. In addition, small firms are unable to obtain the benefits of self insurance and therefore must comply with expensive state-mandated benefit laws, pay state premium taxes, and shoulder a larger portion of the carrier's administrative expenses.

Small businesses are reaching the peak of the frustration level. The reluctant call for help comes as a result of the clash between values and reality. Small business owners believe that every American has a right to health care. Small business owners also desire to offer health insurance as a fringe benefit out of both a sense of familial obligation and competitive necessity. However, 20% to 300% premium increases, a low profit margin, struggling regional economies, and restricted cash flow impair the business' ability to purchase health insurance.

The causes of the cost crisis are numerous and result from not allowing the marketplace to operate efficiently. They can be divided into four generic categories: the reneging of government obligations; government-erected barriers to offering health insurance; medical inflation; and insurance industry practices. Factored into the equation are variables unique to the small business community that make small businesses especially vulnerable to the workings of this disjointed marketplace.

Two thirds of small businesses offer health insurance. In general, these firms tend to be more mature, more profitable, and have more full-time employees than their counterparts that do not offer health insurance. Despite being fairly stable, these small firms experience high initial premiums and higher renewal premiums. Frequently-cited reasons for the high cost of health insurance for small firms include:

- o insurer fear of adverse selection
- o instability of the firm
- o lack of expert help in choosing plans
- o little negotiating clout
- o strict experience rating
- o nature of the small business workforce:
  - a) labor intensive
  - b) high percentage of part-time employees
  - c) high percentage of older workers
  - d) high percentage of very young workers
  - e) more remedial workers
  - f) high turnover
- o high administrative costs for the carrier
- o insufficient experience data
- o absence of preferential treatment afforded to larger firms
- o imposition of state premium taxes

For those not offering health insurance, the following factors have been consistently identified as the most common inherent barriers to offering health insurance:

- o Cost of premiums or past increases too great
- o Insufficient profits
- o Insufficient cash-flow
- o Employee turnover too great
- o Too many employees covered elsewhere -- secondary wage earners
- o Too many part-time employees
- o Too many older employees
- o Employees prefer cash compensation
- o Too small to receive group "discounts"
- o No suitable cost-containment options available

The above "inherent" factors, coupled with the currently fractured marketplace, result in limited availability of health insurance for small business.

NFIB believes that the issues of cost and access are one and indivisible. Universal access to either insurance or medical care hinges upon both being affordable to the purchaser. Reforms cannot focus upon just one aspect of the problem and be successful.

To address the issue of the uninsured, NFIB has developed a strategy to attack the rapidly increasing health insurance premiums charged to small firms. The strategy encompasses the four principal contributors to the current crisis -- the government, health care providers, insurance industry, and the purchaser. It aims at returning the business of insurance to the "law of large numbers" and restoring a competitive marketplace. We would be delighted to discuss this strategy termed the "Access for Small Business" plan with you. I am including a general outline of it in my written testimony.

Mr. Chairman, thank you for the opportunity to testify before the Small Business Committee to discuss the issues of payroll taxes and health care. We look forward to working closely with you to ensure that these proposals become a reality.

Access for Small Business Strategy

I. **Federal Government Obligations. In at least four separate areas, the federal government has avoided express obligations.**

1) **Medicaid. Medicaid is no longer a safety net for low income individuals. Medicaid should be reformed to ensure that it fully serves its intended population.**

2) **Medicare. Medicare has had a serious impact upon the operation of the health care marketplace, including the institutionalization of both cost-plus reimbursement and cost-shifting. Medicare must be redesigned in order to maintain its commitment to the elderly and disabled, but also to reduce its impact upon the remaining marketplace.**

NFIB does not offer specific recommendations other than urge legislators to recognize the large, distorting role both federal programs play in the health care marketplace -- over one-third of all U.S. medical expenditures are incurred by these programs.

3) Full deduction of health insurance costs for the self-employed: partnership, sole proprietorship, and S-corporation business owners. Almost one-half of the businesses in this country are considered "self employed", yet they are discriminated against by the federal tax code. The owners of these businesses only receive a 25% deduction for their health insurance premium costs, while their incorporated counterparts receive a full 100%.

It is estimated that 1 in 6 self-employed business owners are uninsured. A full 100% deduction helps to defray the high cost of premiums, sometimes the highest in a carrier's portfolio because of the very small size of these firms, and encourages the provision of health insurance to their employees.

4) COBRA should be repealed as a business obligation. COBRA acts as an important safety net for former employees. However, the obligation should fall to the state or federal governments to allow those individuals to buy in to a government-sponsored employee health insurance plan. Further, COBRA requires employers to remain the primary insurer for Medicare-eligible employees and to cover former employees for up to 29 months who are Medicare "wait-listed." Both provisions are budget-driven policy decisions, enacted with little regard to the impact upon premium costs of small firms.

Consistent with the small business belief in fiscal responsibility, the above reforms require a concentration and prioritization of overall federal effort, rather than an increase in federal spending.

II. Removal of Barriers

The insurance marketplace must be leveled to remove the current two-tiered effect. The first step is to close the ERISA loophole that permits self insurance, or in the alternative, to confer upon small firms unable to absorb that risk all of the privileges of self insurance, including a credit for state premium taxes paid and "community-rated" premiums. NFIB believes that the best marketplace is one where all businesses are participating, regardless of size or wealth. Additional changes include:

- o Preemption of state health insurance mandates to permit the offering of "barebones" policies. There is consensus in the business and insurance communities that such mandates significantly increase the cost of health insurance for non-self-insured businesses and create demand pull inflation. "Barebones" policies are appealing to the segment of the business community that is currently unable to offer health insurance. Mandate-free policies immediately lower the cost of health insurance for all non self-insured firms by a minimum of 20%.

- o Preemption of state laws which restrict the formation of HMOs, managed care, and other cost containment mechanisms.

- o Simplification or reinstatement of the following tax code provisions:

  a) Cafeteria plans (IRC sec. 125) and reformation of regulations regarding rollover and employer liability.
  b) VEBAs
  c) METs
  d) Individual line item deduction or refundable tax credit, on the E-Z 1040, for the cost of health insurance premiums. This deduction or credit could be means tested to ensure direct targeting to low-income individuals or families.

The last item was permitted until 1981. The first four items represented viable options to help small firms manage the cost of health insurance, but are now so complex that few small firms are able to employ these options.

III. Cost containment -- hospitals, doctors, and patients.

NFIB believes that reforms in other areas will not be successful until medical inflation is conquered. Attainment of significant cost containment must include, but should not be limited to, the following:

- o Consumer empowerment. Patients must have information on fees, treatments, and physician practices. Until the patient becomes an active and informed participant, the type of medical care will remain a negotiating point only between the provider and the insurance carrier.

- o Return to individual responsibility. The competitive marketplace will not succeed unless the patient behaves like a consumer and believes that he/she has a responsibility to make good health care decisions.

- o Data. Outcomes research, provider-developed practice protocols, and hospital ratings are three methods to coalesce and develop information necessary for informed decisionmaking. In addition, such data provide a basis for informed analysis of treatments by providers willing to modify their practices.

- o Wellness education. The key to controlling future health care expenditures is to promote healthy behaviors and preventive care.

- o Medical malpractice reforms. The protocols discussed above should be admitted as defenses in a medical malpractice suit.

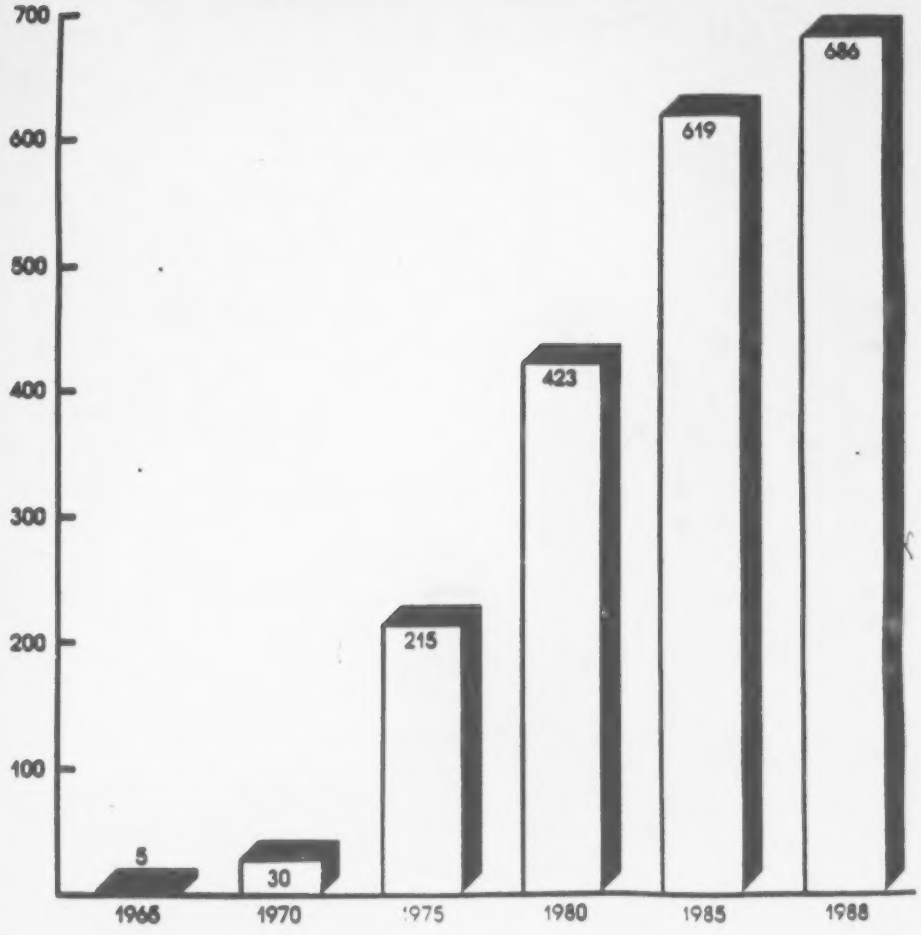
IV. Insurance Industry Reforms

NFIB believes that if the above reforms are implemented, the insurance industry will be forced to operate in accordance with the "law of large numbers," rather than fragmenting the marketplace to the detriment of small business. By re-creating a marketplace where all employees are essentially part of the same pool, interim solutions such as risk pools or reinsurance mechanisms become unnecessary. To facilitate this goal, underwriting reforms must be implemented immediately.

V. Counterproductive Mechanisms

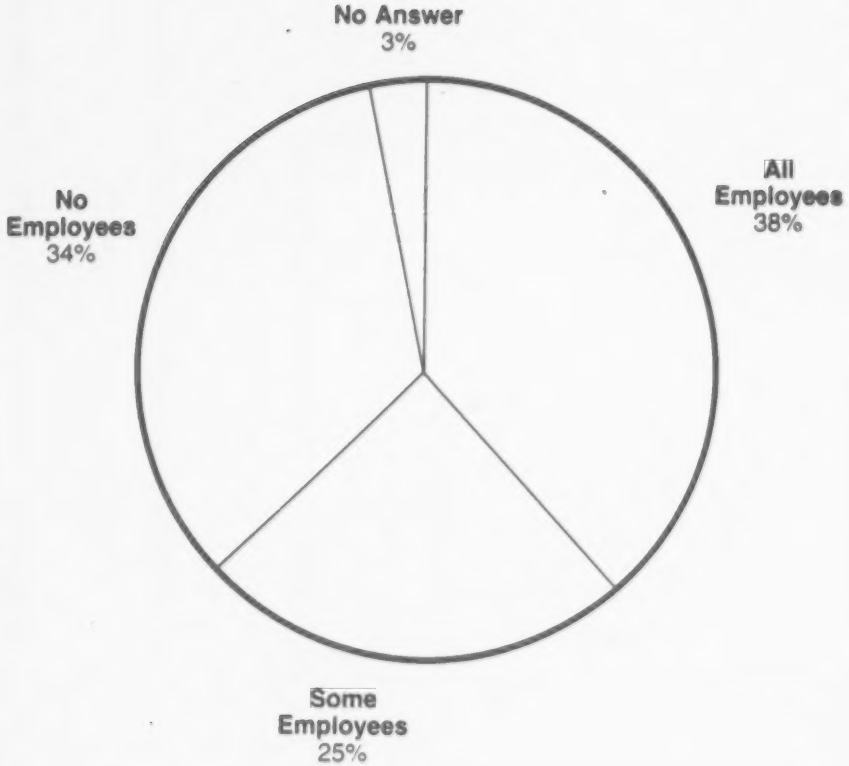
Small business owners are staunchly opposed to any form of mandate. The term "mandate" includes required benefit packages, simple "pay or play" schemes, mandatory risk pools for small firms, triggers, and national health insurance programs.

NUMBER OF MANDATED HEALTH INSURANCE BENEFITS ENACTED BY STATE GOVERNMENTS

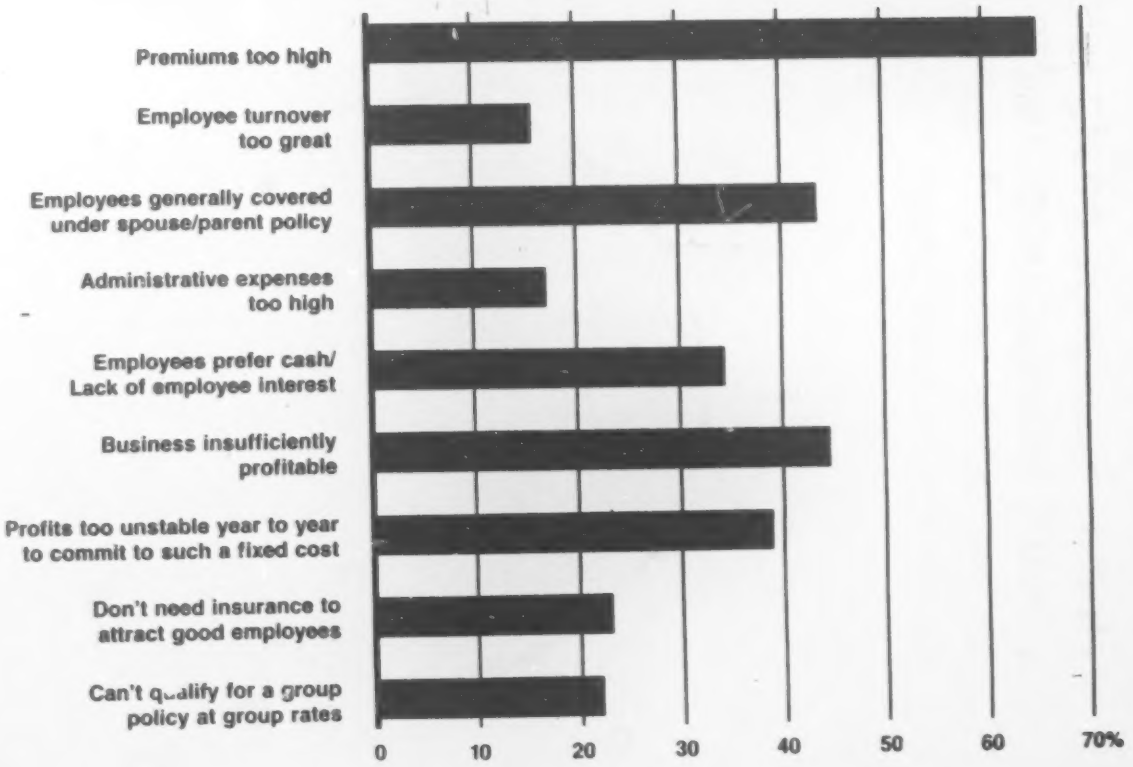


SOURCE BLUE CROSS AND BLUE SHIELD ASSOCIATION

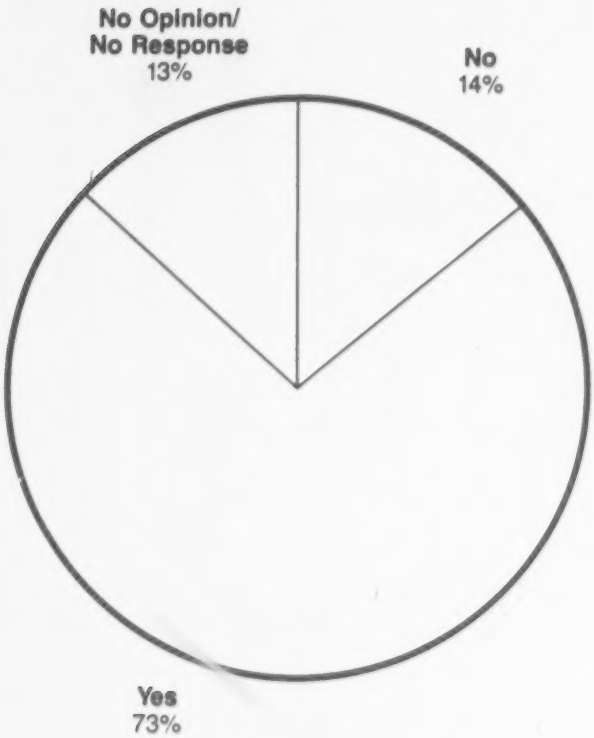
Do you sponsor a health insurance plan for your employees?



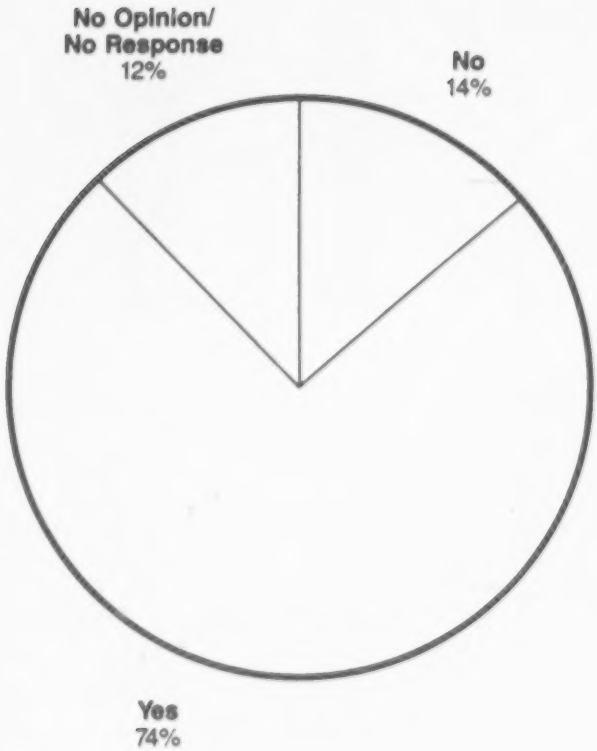
If you do not have an employee health insurance plan, why?



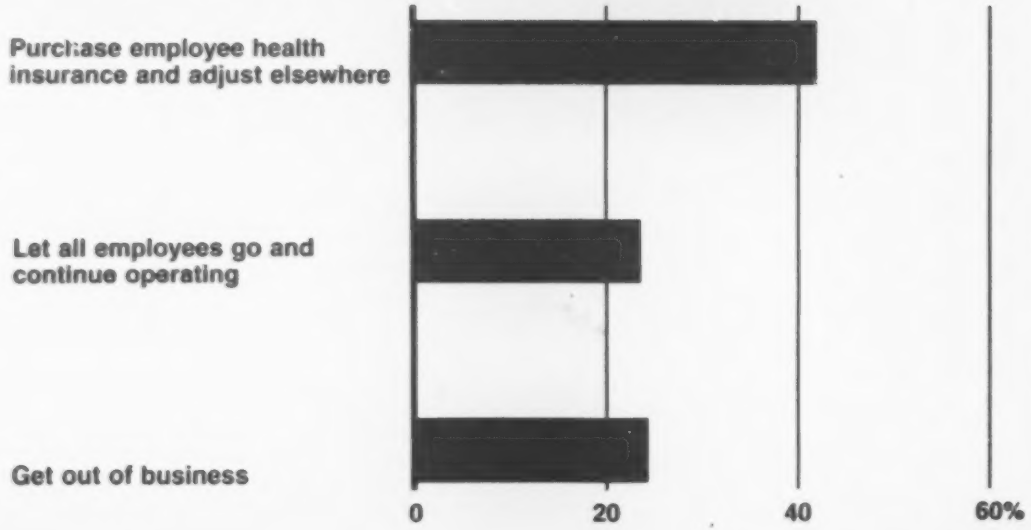
Health insurance costs raise (would raise) payroll costs to the point where it is difficult to compete.



Employees prefer wage increases to increases in health benefits.



Suppose the government required all employers to carry a minimum amount of employee health insurance. The cost of the insurance would be about $150 per employee per month. If this were to occur, how would you respond?



SUMMARY PAGE FOR NFIB TESTIMONY

NFIB

National Federation of Independent Business

The National Federation of Independent Business (NFIB) and its more than 500,000 small business owners across the nation strongly support an immediate rollback of the 1990 Social Security FICA (Federal Insurance Contributions Act) tax increase which went into effect on January 1, 1990. NFIB's membership, and small businesses in general, are concentrated in those sectors of business which tend to be primarily labor intensive. They employ people rather than machines. Payroll taxes, dominated by FICA taxes, therefore place a disproportionate burden on them.

The need to reduce the FICA tax rate is of critical importance to NFIB small business owners across the country for the following reasons. First, small business owners pay significantly more in FICA taxes than income taxes. Small business owners must pay half of the 15.3 percent FICA tax for all their employees. Secondly, the FICA tax burden discourages many individuals from pursuing the American dream of starting up a new small business. For those small businesses in trouble, the FICA tax burden can be the last straw before a business is forced to close down. In addition, the FICA tax burden hinders small businesses from creating new jobs. Over 70% of the 17 million net new jobs created in this decade have been in small firms. Finally, the FICA tax increases affect self-employed business owners in an even more dramatic way than other small business owners since these business owners are forced to pay the entire FICA tax payment.

Small business owners need Congressional help to alleviate their payroll tax burden by passing legislation which eliminates the 1990 FICA tax increase and provides for further FICA tax reductions while still ensuring fiscal responsibility with regard to the budget.

Concerning the health care crisis, small business owners are the victims of a two-tiered problem: first, rising health care inflation and second, rising health insurance premiums or the unavailability of insurance. Both have one common element -- cost. Cost restricts the access of small businesses and individuals to the system. The causes of the cost crisis are numerous and result from not allowing the marketplace to operate efficiently. They can be divided into four generic categories: the reneging of government obligations; government-erected barriers to offering health insurance; medical inflation; and insurance industry practices.

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The Guardian of Small Business

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